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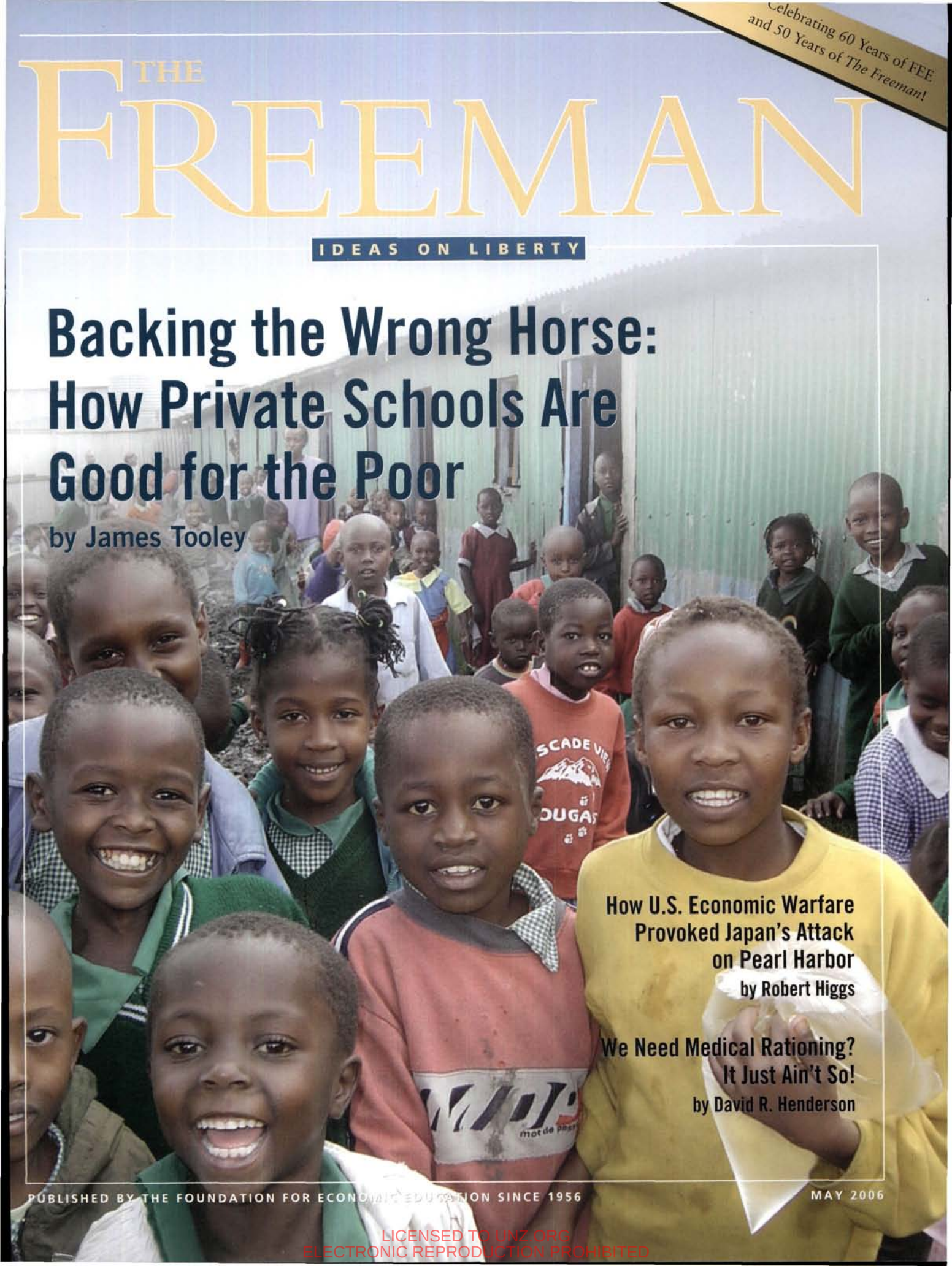
THE FREEMAN

IDEAS ON LIBERTY

Backing the Wrong Horse: How Private Schools Are Good for the Poor

by James Tooley



How U.S. Economic Warfare Provoked Japan's Attack on Pearl Harbor

by Robert Higgs

We Need Medical Rationing? It Just Ain't So!

by David R. Henderson

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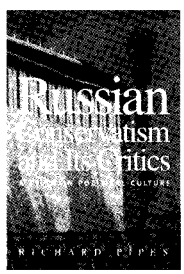

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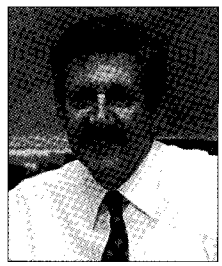
John Maynard Keynes: The Damage Still Done by a Defunct Economist



BY RICHARD M. EBELING

Seventy years ago, on February 4, 1936, the English economist John Maynard Keynes (1883–1946) published what soon became his most famous work, *The General Theory of Employment, Interest, and Money*. Few books, in so short a time, have gained such wide influence and generated so destructive an impact on public policy. What Keynes succeeded in doing was to provide a rationale for what governments always like to do: spend money and pander to special interests.

In the process Keynes helped undermine what had been three of the essential institutional ingredients of a free-market economy: the gold standard, balanced government budgets, and open competitive markets. In their place Keynes's legacy has given us paper-money inflation, government deficit spending, and more political intervention throughout the market.

It would, of course, be an exaggeration to claim that without Keynes and the Keynesian revolution inflation, deficit spending, and interventionism would not have occurred. For decades before the appearance of Keynes's book, the political and ideological climate had been shifting toward ever-greater government involvement in social and economic affairs, due to the growing influence of collectivist ideas among intellectuals and policymakers.

But before the appearance of *The General Theory*, many of the advocates of such collectivist policies had to get around the main body of economic thinking which still argued that in general the best course was for government to keep its hands off the market, maintain a stable currency backed by gold, and restrain its own taxing and spending policies.

The classical economists of the eighteenth and nineteenth centuries had persuasively demonstrated that government intervention prevented the smooth functioning of the market. They constructed a body of economic theory which clearly showed that governments have neither the knowledge nor the ability to direct economic affairs. Freedom and prosperity are best assured when government is, in general, limited to protecting people's lives and property, with the competitive forces of supply and demand bringing about the necessary incentives and coordination of people's activities.

During the Napoleonic wars of the early nineteenth century, many European countries experienced serious inflations as governments resorted to the printing press to fund their war expenditures. The lesson the classical economists learned was that the hand of the government had to be removed from the handle of that printing press if monetary stability was to be maintained. The best way of doing this was to link a nation's currency to a commodity like gold, require banks to redeem their notes for gold on demand at a fixed rate of exchange, and limit any increases in the amount of such bank notes in circulation to additional deposits of gold left in the banks by their depositors.

They also concluded that deficit spending was a dangerous means of funding government programs. It enabled governments to create the illusion that they could spend without imposing a cost on society in the form of higher taxes; they could borrow and spend today, and defer the tax cost until some tomorrow when the loans would have to be repaid. The classical economists called for annually balanced budgets, enabling the electorate to see more clearly the cost of government spending. If a national emergency, such as a war, were to force the government to borrow, then when the crisis passed, the government should run budget surpluses to pay off the debt.

These were considered the tried and true policies for a healthy society. And these were the policies that Keynes did his best to try to overthrow in the pages of *The General Theory*. He argued that a market economy was inherently unstable, open to swings of irrational

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investor optimism and pessimism, which resulted in unpredictable and wide fluctuations in output, employment, and prices. Only government, he believed, could take the long view and rationally keep the economy on an even keel by running deficits to stimulate the economy during depressions and surpluses to rein it in during inflationary booms. He therefore attacked the notion of annual balanced budgets; instead, government should balance its budget over the "business cycle."

To do this job, Keynes said, governments could not be hamstrung by the "barbarous relic" of the gold standard. Wise politicians, guided by brilliant economists like himself, had to have the flexibility to increase the money supply, manipulate interest rates, and change the foreign-exchange rates at which currencies traded for each other. They required this power so they could generate any amount of spending needed to put people back to work through public-works projects and government-stimulated private investments. Limiting increases in the money supply to the quantity of gold would only get in the way, Keynes insisted.

Keynes believed not only that the market economy could not keep itself on an even keel, he also believed that it would be undesirable to allow the market to work. He once said that to have the market determine prices and wages to balance supply and demand was to submit society to a cruel and unjust "economic juggernaut." Instead, he wanted wages and prices to be politically fixed on the basis of "what is 'fair' and 'reasonable' as between the [social] classes."

The level of wages imposed by trade unions, for example, was to be viewed as sacrosanct, even if many workers were priced out of the market because the level was higher than potential employers thought those workers were worth. The government, instead, was to print money, run deficits, and push up prices to any level needed to make it again profitable for employers to hire workers. In other words, perpetual price inflation was to be the means to assure "full employment" in the face of aggressive trade unions.

No Check on Spending

In addition, when the balanced-budget rule was overthrown there was no longer any check on government spending. As James M. Buchanan and Richard E. Wagner pointed out in *Democracy in Deficit* (1977), once government is freed from the restraint of making taxpayers directly and immediately pay for what it spends, every conceivable special-interest group can appeal to the politicians to feed their wants. The politicians, desiring votes and campaign contributions, happily offer to satisfy the gluttony of favored groups. At the same time, the taxpayers easily fall prey to the delusion that government can give something for nothing to virtually everyone at no cost to them.

Indeed, politicians can now play the game of offering more and more dollars to special interests, while lowering taxes. The government simply fills the gap by borrowing, imposing a greater debt burden on future generations. Either taxes will have to go up in the years ahead or the government will turn to the printing press to pay what it owes, all the while claiming that it's being done to generate "national prosperity" and fund the "socially necessary" programs of the welfare state.

In one of the most famous passages in *The General Theory*, Keynes said that "the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back."

Seventy years after the appearance of *The General Theory*, many practical men of affairs and politicians in authority remain the slaves of defunct economists and academic scribblers. The tragedy for our times is that among the voices they still hear in the air as they corruptly mismanage everything they touch is that of John Maynard Keynes.

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Perspective

Legal Plunder Mislabeled "Defense"

Arnaud de Borchgrave of United Press International has been reporting on national intelligence matters for many years. In a recent dispatch he wrote that "[s]ome 15,300 earmarks in the U.S. defense budget, up 1,300 percent in the 21st century, are so many pork projects for lawmakers' constituencies that have nothing to do with defense." That averages to nearly 29 earmarks per member of Congress. When a congressman wants to score points with influential voters in his state or district, he gets an appropriation added to a bill, earmarking money for a project tailored to make those voters eternally grateful—at least through election day.

It's tempting to think the military budget is different from the rest of the government's budget. Politics surely would not intrude on such an important matter. But we know better. The Pentagon is as much a part of the bureaucracy as any other department. We may hate to accept it, but weapons systems, military aircraft, and naval ships have been built solely because they created or maintained jobs in an important congressman's district. If de Borchgrave is right, this is more popular than ever.

Classical liberals have long warned of this practice. Milton Friedman criticized it in his book from the 1980s *The Tyranny of the Status Quo*. Liberals further back have sounded the same tocsin. For example, John Bright, the great peace-and-free-trade activist and member of Parliament, in 1858 condemned the British government's "excessive love for the 'balance of power' [as] neither more nor less than a gigantic system of out-door relief for the aristocracy of Great Britain."

A similar point was made in the twentieth century by the liberal journalist John T. Flynn in his 1944 book *As We Go Marching*, the classic study of the rise of fascism in Italy and Nazism in Germany. Long before Mussolini, Flynn wrote, Italian governments had increased expenditures, taxation, and debt through programs intended to please constituencies and keep the economy going. Even before Keynes published his *General Theory* in 1936, politicians feared that without big government spending, depression and destabilizing unemployment would be the rule. So they spent, taxed, and borrowed.

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"But this policy does run into resistance—and resistance in very influential quarters," Flynn wrote. "The large taxpayer is against it. He acquiesces reluctantly. And as the debt grows and he looks with growing fear on its future proportions he begins to exert his full influence against it. In different countries the basis of resistance takes different forms, but it comes chiefly from the conservative groups. Hence it becomes increasingly difficult to go on spending in the presence of persisting deficits and rising debt. Some form of spending must be found that will command the support of the conservative groups. Political leaders, embarrassed by their subsidies to the poor, soon learned that one of the easiest ways to spend money is on military establishments and armaments, because it commands the support of the groups most opposed to spending. . . .

"Thus it was because the government could get public agreement for loans for this purpose and because such loans were essential to the policy of spending which kept the floundering economic system going that the militaristic policy remained so vital and vigorous an institution in Italy—and in every other continental country. . . .

"I must not leave this whole subject of spending and the means employed to spend, including militarism, without observing that there is nothing new in it. It is as old as civilized government. And what is more, the protagonists of it have understood precisely what they are doing."

We have learned from the Public Choice school of political economy that benefits from government spending are concentrated on relatively small self-conscious interest groups, while the costs are spread thinly among the mass of taxpayers. Hence the beneficiaries have far more incentive to work the halls of government than do the preoccupied taxpayers. No wonder interest groups have the advantage. When the label "national security" is affixed to a spending bill, so much the better for the relevant group, and so much the worse for the taxpayers, who are in no position to verify the claim.

What's the moral here? That anything called defense is bogus? Of course not. The moral is that given the coercive and expansive nature of the political process, the appropriate attitude of the taxpayer is skepticism, or as Jefferson put it, "jealousy," rather than confidence.

★ ★ ★

Any advocate of separating school and state is immediately hit with the challenge: "But what about the poor?" Up until now we could draw on theory and history for an answer. But now we have contemporary examples from the poorest countries of the developing world. James Tooley reports on his path-breaking research.

Ludwig von Mises was arguably the greatest economist and advocate of free markets in the twentieth century. In this first of two articles, Richard Ebeling details Mises's contributions to sound economic thinking and the cause of liberty.

Elections in Germany and Japan could herald an end to their experiments with the Third Way. Norman Barry looks behind the headlines.

During his long career F. A. Hayek wrote volumes not just on economics, but on broader social philosophy as well. After a rare chance to examine Hayek's private notes, Steven Horwitz discusses the great thinker's worldview.

The standard bill of indictment against the free market has a curious feature: all the alleged offenses have their roots in government intervention. Joseph Stromberg has the particulars.

FEE is celebrating its 60th anniversary this year. Whom better to turn to for an early history than Henry Hazlitt. He provides this month's Timely Classic.

The Freeman's columnists have hit on another set of fascinating topics. Richard Ebeling revisits Keynes's *General Theory*. Lawrence Reed recounts his favorite freedom-oriented movies. Thomas Szasz explores psychiatry's concepts of mental illness and brain disorder, and their relationship to freedom. Robert Higgs examines U.S. economic policy before Japan's attack on Pearl Harbor. Charles Baird looks at a dispute between organized labor and the National Organization for Women. And David Henderson, reading a case for medical rationing, responds, "It Just Ain't So!"

Books coming under review this issue scrutinize Russian conservatism, the miracle of electronic transactions, the "new new left," and economic sense.

—Sheldon Richman
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We Need Medical Rationing? It Just Ain't So!

BY DAVID R. HENDERSON

In a recent op-ed in the *Los Angeles Times* ("A Health Care Prescription that's Hard to Swallow," January 30, 2006), Henry Aaron, a well-known health economist at the Brookings Institution, made the following argument:

Spending on health care in the United States is rising as a percent of GDP and could go from its current 16 percent to as much as 33 percent by 2030. Because higher taxes will be needed to pay for projected increases in Medicare and Medicaid, the government should ration health care, that is, restrict purchases of costly medical equipment, put caps on hospital budgets, and enforce protocols on treatments for various ailments—in other words, forcibly prevent people from getting certain treatments.

But Aaron's drastic political solution does not follow from his statement of the problem. In fact, Aaron does a sleight of hand that, unfortunately, probably far too few readers caught.

Aaron is right to say that we need to rein in government spending on Medicare and Medicaid. Socialized medicine for the elderly and the poor was never a good idea, and measures to limit such spending—higher co-pays, lowering the income at which someone can qualify for Medicaid, and raising the age at which people can qualify for Medicare from its current level of 65—make sense. Indeed, phasing out both programs makes sense and is justified on moral grounds also: forcibly taking money from some to pay for others' health care is wrong. It's even harder to argue for forcibly taking money from workers to pay for the health care of the elderly, who are, in fact, the second-richest age group (measured by wealth rather than income) in America.

But how does Aaron get from the fact that an unchecked Medicare and Medicaid will require higher taxes to his conclusion that health care should be rationed for all, including those who have their own insurance or who pay out of their own pockets? He doesn't tell us. Aaron seems to believe that because the growth of Medicare and Medicaid should be cut, it's only fair to limit what others can spend on health care also. If this is his argument, would Aaron apply it more generally? Under some states' welfare programs, for example, welfare recipients are not allowed to own cars. Would Aaron argue that as long as such restrictions remain, people *not* on welfare should not be allowed to own cars? I doubt it.

We are led to conclude, then, that in Aaron's mind, health care is special. What makes it special? He doesn't say, but we can speculate. Perhaps Aaron thinks consumption of health care should not depend on people's income or wealth, and so he wants government to prohibit you from spending your own money as you see fit in that regard.

Aaron could have made another argument for why health care is special. The U.S. health-care market, contrary to what many people assert, is one of the most regulated industries in America. In all states the supply of doctors and drugs is regulated by laws that raise prices and make many drugs unavailable. Hospitals and health insurance, which is how most people pay for health care, are also highly regulated.

David Henderson(drhend@mbay.net) is a research fellow with the Hoover Institution and an economics professor at the Naval Postgraduate School in Monterey, California. He was previously the senior economist for health policy with the President's Council of Economic Advisers. His latest book, coauthored with Charles L. Hooper, is Making Great Decisions in Business and Life *(Chicago Park Press, 2006).*

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Aaron points out that insured patients "pay little of the cost of their own care when ill." Thus they "want everything that might conceivably add even some tiny benefit," no matter the cost. But when insuring my house, I would want every little benefit, no matter the cost, as long as I didn't have to pay for it. Yet no one is pointing to a house-insurance crisis. Why? Because the companies that sell us house insurance have clear-cut lists of what they will pay for and what they won't.

The same applies to health insurance, with this crucial difference: if the insurance policy covers a particular ailment, the law requires the insurer to provide any benefits that are "medically necessary" for treating it. The law is generally interpreted broadly to cover all the latest treatments, no matter how expensive. This means that an insurance company in the United States cannot offer a "Chevrolet" policy for dealing with, say, kidney disease; if the policy covers kidney disease, it must be "Lexus" coverage. Yet, arguably, a huge percent of the uninsured would gladly pay a substantially lower premium for "Chevrolet" coverage rather than go without. One could even imagine people being willing to pay low premiums to get "Canadian-style" coverage, which, in automobile terms, is a Yugo. Canadians and Americans are not that different. A sizeable percent of the Canadian population has become accustomed to, and apparently comfortable with, waiting months between diagnosis and surgery, even for such important things as heart disease and lung cancer. Possibly, some of the push in America for Canadian-style health care reflects many Americans' desire to pay less and get in a queue. So let them.

I don't advocate *imposing* Canadian health care; I do advocate *allowing* it. Yet regulations prevent it. And one good side effect of allowing Canadian-style health care is that it would reduce the size and power of the coalition that is pushing to impose that system on all Americans. The root of the problem that Aaron identifies is regulation that prevents buyers and sellers from making mutually beneficial exchanges: this regulation puts government in the role of dictating what can be bought and sold.

Missing the Logical Step

Aaron points to the inevitable result of patients paying such a small percentage of their health-care costs. But he doesn't take the logical step of suggesting that Medicare and Medicaid patients pay a higher percentage. Why limit their choices with a heavy-handed, one-size-fits-all mandate from above when a simple change would save the two programs' budgets and allow patients and their doctors to choose which treatments are worth the price and which aren't?

And here's the irony. The plan Aaron advocates looks quite a bit like Canadian-style health care. Restrictions on purchases of medical equipment, caps on hospital budgets, and enforced protocols on treatments—these are all important parts of Canada's socialized system. Aaron writes that politicians insist "they will fight off efforts to deny the insured any beneficial service that insurance covers." In other words, Aaron seems to understand the problem: government regulation prevents insurers from making sensible attempts to offer less-generous insurance policies. But rather than advocate allowing less-generous insurance policies, Aaron takes an even more drastic step of advocating forced rationing. In other words, rather than advocate a modest policy that goes against the current political mindset, Aaron advocates a drastic policy that goes against that mindset. Is it possible that Aaron has a romantic attachment to government control and regulation and that this attachment prevents him from seeing the solution clearly?

Finally, Aaron's implicit assumption that it's bad to spend 33 percent of GDP on health care is unfounded. If the incentives are right—so that people are spending their own money on health care or health insurance, are not subsidized to do so, and are allowed less-generous health-insurance policies—what's wrong with spending 33 percent of GDP on health care? If spending 33 percent of your income every year for the next 20 years would save your child's life, would you do it? And if you would, what would you think of someone who tried to stop you?

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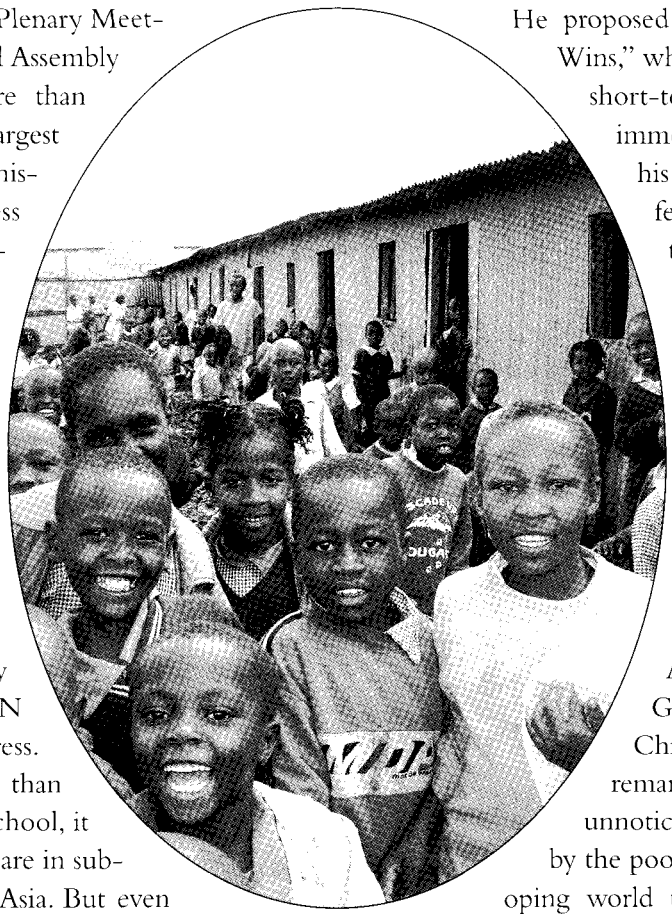
Backing the Wrong Horse: How Private Schools Are Good for the Poor

BY JAMES TOOLEY

Last fall the High-Level Plenary Meeting of the UN General Assembly brought together more than 170 heads of state—"the largest gathering of world leaders in history"—to review progress toward the Millennium Development Goals. It was, we were told, "a once-in-a-generation opportunity to take bold decisions," a "defining moment in history" when "we must be ambitious."

One of the internationally agreed-on development goals the heads of state reviewed was the achievement of universal primary education by 2015. The UN was not happy with progress. There are still officially more than 115 million children out of school, it reported, of which 80 percent are in sub-Saharan Africa and Southern Asia. But even for those lucky enough to be in school, things are not good: "Most poor children who attend primary school in the developing world learn shockingly little," the UN reported.



Pupils at River of Life private school in the slum of Mukuru, Nairobi, Kenya

Something had to be done. Fortunately, the UN could call on Jeffrey D. Sachs, special adviser on the Millennium Development Goals to Secretary-General Kofi Annan and author of *The End of Poverty*. He's also director of the Earth Institute at Columbia University. He proposed as the way forward "Quick Wins," which have "very high potential short-term impact" and that "can be immediately implemented." Top of his list is "Eliminating school fees," to be achieved "no later than the end of 2006," funded through increased international donor aid. To the UN it's as obvious as motherhood and apple pie.

But the UN's "Quick Wins" are backing the wrong horse. For the past two and a half years I've been directing and conducting research in sub-Saharan Africa (Kenya, Nigeria, and Ghana) and Asia (India and China). And what I've found is a remarkable and apparently hitherto unnoticed revolution in education, led by the poor themselves. Across the developing world the poor are eschewing free state education, disturbed by its low quality and lack of accountability. Meanwhile, educational entrepreneurs from the poor communities themselves set up affordable private schools to cater to the unfulfilled demand.

James Tooley (James.Tooley@newcastle.ac.uk) is professor of education policy at the University of Newcastle, director of the E.G. West Centre, and coauthor of "Private Education Is Good for the Poor: A Study of Private Schools Serving the Poor in Low-Income Countries" (Cato Institute).

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Take Kibera, in Nairobi, Kenya, reportedly the largest slum in Africa, where half a million people live in mud-walled, corrugated iron-roofed huts that huddle along the old Uganda Railway. Kenya is one of the UN's showcase examples of the virtues of introducing free basic education. Free Primary Education (FPE) was introduced in Kenya in January 2003, with a $55 million donation from the World Bank—apparently the largest straight grant that it has given to any area of social services. The world has been impressed by the outcomes: Former President Bill Clinton told an American prime-time television audience that the person he most wanted to meet was President Kibaki of Kenya, "because he has abolished school fees," which "would affect more lives than any president had done or would ever do." The British chancellor of the exchequer, Gordon Brown, visiting Olympic Primary School, one of the five government schools located on the outskirts of Kibera, told the gathered crowds that British parents gave their full support to their tax money being used to support FPE. Everyone—including Sir Bob Geldof and Bono—raves on about how an additional 1.3 million children are now enrolled in primary school in Kenya. All these children, the accepted wisdom goes, have been saved from ignorance by the benevolence of the international community—which must give $7 billion to $8 billion *per year* more so that other countries can emulate Kenya's success.

The poor in Africa have not been waiting helplessly for the munificence of pop stars and Western politicians to ensure that their children get a decent education.

The accepted wisdom, however, is entirely wrong. It ignores the remarkable reality that the poor in Africa have not been waiting helplessly for the munificence of pop stars and Western politicians to ensure that their children get a decent education. The reality is that *private schools for the poor* have emerged in huge numbers in some of the most impoverished slums in Africa and southern Asia. They are catering to a majority of poor children, and outperforming their government counterparts, for a fraction of the cost.

I went to Kibera to see for myself, with a hunch that the headline success story might be concealing something. In India I had seen that the poor were not at all happy with the government schools—a recent study had shown that when researchers called unannounced on government schools for the poor, only in half was there any teaching going on at all—and so were leaving in huge numbers to go to private schools set up by local entrepreneurs charging very low fees. Would Kenya be any different? Although the education minister told me that in his country private schools were for the rich, not the poor, and so I was misguided in my quest, I persevered and went to the slums. It was one of Nairobi's two rainy seasons. The mud tracks of Kibera were mud baths. I picked my way with care.

Within a few minutes, I found what I was looking for. A signboard proclaimed "Makina Primary School" outside a two-story rickety tin building. Inside a cramped office Jane Yavetsi, the school proprietor, was keen to tell her story: "Free education is a big problem," she said. Since its introduction, her enrollment had declined from 500 to 300, and now she doesn't know how she will pay the rent on her buildings. Many parents have opted to stay, but it is the wealthier of her poor parents who have taken their children away, and they were the ones who paid their fees on time. Her school fees are about 200 Kenyan shillings (about $2.80) per month. But for the poorest children, including 50 orphans, she offers free education. She founded the school ten years ago and has been through many difficulties. But now she feels crestfallen: "With free education, I am being hit very hard."

Jane's wasn't the only private school in Kibera. Right next door was another, and then just down from her, opposite each other on the railway tracks, were two more. Inspired by what I had found, I recruited a local research team, led by James Shikwati of the Inter-Region Economic Network (IREN), and searched every muddy street and alleyway looking for schools. In total we found 76 private schools, enrolling over 12,000 students. In the five government schools serving Kibera, there were a total of about 8,000 children—but half were from the middle-class suburbs. The private schools,

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it turned out, even *after* free public education, were still serving a large majority of the poor slum children.

A Typical Experience?

Was Jane's experience typical since the introduction of free primary education? Most of the 70-odd private-school owners in Kibera reported sharply declining enrollment since the introduction of FPE. Many, however, were reporting that parents had at first taken their children away, but were now bringing them back—because they hadn't liked what they'd found in the government schools. We also found the ex-managers of 35 private schools that had closed since FPE was introduced, 25 of whom said that it was FPE that had led to their demise. Calculating the net decline in private-school enrollment, it turned out that there were many, many more children who had left the private schools than the 3,300 reported to have entered the government schools on Kibera's periphery and who were part of the much celebrated one million-plus supposedly newly enrolled in education.

In other words, the headlined increase in numbers of enrolled children was fictitious: the net impact of FPE was at best precisely the same number of children enrolled in primary school—only that some had transferred from private to government schools.

I discussed these findings with senior government, World Bank, and other aid officials. They were surprised by the number of private schools I had found. But, they said, if children had transferred from private to state schools, then this was good: "No one believes that the private schools offer quality education," I was told. British Prime Minister Tony Blair's Commission for Africa agrees: conceding that mushrooming private schools exist in some unspecified parts of sub-Saharan Africa, it reports that they "are without adequate state regulation and are of a low quality."

But why would parents be as foolhardy to pay to send their children to schools of such low quality? One school owner in a similar situation in Ghana, where we later conducted the research, challenged me when I observed that her school building was little more than a corrugated iron roof on rickety poles and that the government school, just a few hundred yards away, was a smart, proper brick building. "Education is not about buildings," she scolded. "What matters is what is in the teacher's heart. In our hearts, we love the children and do our best for them." She left it open, when probed, what the teachers in the government school felt in their hearts toward the poor children.

A typical private school in rural Badagry, Lagos State, Nigeria

Exploring further in Kenya, my team and I spoke to parents, some of whom had taken their children to the "free" government schools, but had been disillusioned by what they found and returned to the private schools. Their reasons were straightforward: in the government schools class sizes had increased dramatically and teachers couldn't cope with 100 or more pupils, five times the number in the private-school classes. Parents compared notes when their children came home from school and saw that

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in the state schools pupil notebooks remained unmarked for weeks; they contrasted this with the detailed attention given to all children's work in the private schools. They heard tales from their children of how teachers came to the state school and did their knitting or fell asleep. One summed up the situation succinctly: "If you go to a market and are offered free fruit and vegetables, they will be rotten. If you want fresh fruit and veg, you have to pay for them."

Perhaps these poor parents are misguided. Certainly that's what officials believe. But are they right? We tested 3,000 children, roughly half from the Nairobi slums and half from the government schools on the periphery, using standardized tests in math, English, and Kiswahili. We tested the children's and their teachers' IQs and gave questionnaires to pupils, their parents, teachers, and school managers so that we could control for all relevant background variables. Although the government schools served the privileged middle classes as well as the slum children, the private schools—serving only slum children—outperformed the government schools in mathematics and Kiswahili, although the latter had a slight advantage in English. But English would be picked up by privileged children through television and interaction with parents. When we statistically controlled for all relevant background variables, the private schools outperformed the government schoolchildren in all three subjects.

The private schools outperformed the government schools for considerably lower cost even if we ignore the massive costs of the government bureaucracy and focus just on the classroom level.

But there was a further twist. The private schools outperformed the government schools for considerably lower cost. Even if we ignore the massive costs of the government bureaucracy and focus just on the classroom level, we find the private schools are doing better for about a third of teacher-salary costs: the average monthly teacher salary in government schools was Ksh. 11,080 ($155) compared to Ksh. 3,735 ($52) in the private schools.

Free primary education in Kenya, a showcase example of the UN's "Quick Wins" strategy, has simply transferred children from private schools, where they got a good deal, closely supervised by parents, with teachers who turn up and teach, to state schools, where they are being dramatically let down. One parent was clear what the solution was: "We do not want our children to go to a state school. The government offered free education. Why didn't it give us the money instead and let us choose where to send our children?" For this parent, a voucher system was the obvious way forward, putting her right back in control.

Perpetual "Aid"

Perhaps some will argue that these are teething problems and the UN's "Quick Wins" need time to bed down. The evidence does not support this either. Take Nigeria, for example, which introduced its free primary education act in 1976. Ever since, state education has been backed by huge dollops of international aid, but it doesn't seem much to celebrate.

Drive across the low highway viaduct over toward Victoria Island, in the bustling city of Lagos, for instance, and you'll see the shantytown of Makoko, home to an estimated 50,000 people, sprawling out into the black waters below. Wooden huts on stilts stretch out into the lagoon; young men punt; and women paddle dugout canoes down into narrow canals weaving between the raised homes. Across the top of the shantytown, there is a veneer of drifting smog created by the open fires used for cooking. Again, it's the last place that you'd expect to witness an educational revolution taking place. But, again, that's precisely what's happening.

To get to Makoko by road, you'll need to turn off Third Mainland Bridge, into the congested Murtal Muhammed Way and sharply into Makoko Street, easing past the women crowding the streets selling tomatoes, peppers, yams, chilies, and crayfish. At the end of this road, there is the entrance to two parallel and imposing four-story concrete buildings. These buildings contain

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One of 76 private schools the author and his team found in the slum of Kibera, Nairobi, Kenya

three public primary schools, originally church schools nationalized by the state in the 1980s, all on the same site, designed by the state officials to serve the whole population of Makoko.

Visiting these three public schools is a dispiriting experience. Our visit was a scheduled one; the schools had had time to prepare. But even so, in most of the classrooms, the children seemed to be doing very little. In one the young male teacher was fast asleep at his desk, not aroused even when the children rose to noisily chant greetings to their visitors. In others the teacher was sitting reading a newspaper or chatting with someone outside the door, having written a few simple things on the board, which the class had finished copying. In one of the three schools, Grade 1 had 95 children present, three classes put together because of long-term teacher absenteeism. The children were doing nothing; some were also sleeping; one girl was cleaning the windows. The one teacher was hanging around outside the class door. No one, certainly not the headmistress, seemed remotely embarrassed by any of this. I asked the children what lesson they were doing—when no one responded, the head teacher bellowed at the pupils to get an answer; "It is a mathematics lesson," she reported, pleasantly, without any sense of incongruity, for no child had a single book open.

This one of the three schools alone could accommodate 1,500 children. The headmistress told us that parents left the school en masse a few years earlier because of teacher strikes. But things have improved, and children have returned, she said, with 500 now enrolled. On the top floor of the stark building, however, there were six classrooms empty, all complete with desks and chairs, waiting for children to return. "Why don't parents send their children here?" we asked the headmistress. Her explanation was simple: "Parents in the slums don't value education. They're illiterate and ignorant. Some don't even know that education is free here. But most can't be bothered to send their children to school." We innocently remarked that we'd heard that, perhaps, parents were sending their children to private schools instead, and were greeted with laughter: "They are very poor families living in the slum . . . . They can't afford private education!"

But she is entirely wrong. Continue past the three public schools, past where the tarred road ends at a raised speed bump, and enter Apollo Street, too muddy for a vehicle. Here you'll need to pick your way carefully, squelching your way from one side of the street to the other, avoiding the worst excesses of the slime and mud and excrement and piled rubbish. Walk alongside the huts visible from the highway—homes made of flat timbers, supported by narrow slithers of planks sunk into the black waters below—and you'll come to a pink plastered concrete building with colorful pictures of children's toys and animals, and "Ken Ade Private School" emblazoned across the top of the wall.

Ken Ade Private School, not on any official list of schools, so unknown to government, is owned by Mr. Bawo Sabo Elieu Ayeseminikan—known to everyone as "B.S.E." B.S.E. had set up the school on April 16, 1990, starting with only five children in the church hall, parents paying fees on a daily basis when they could afford to do so. Now he has about 200 children, from nursery to primary 6. The fees are about 2,200 Nigeria naira ($17) per term, or about $4 per month, but there are 25 children who come for free. "If a child is orphaned, what can I do? I can't send her away," he says.

Philanthropy and Commerce

His motives for setting up the school are a mixture of philanthropy and commerce—yes, he needed work and saw that there was a demand for school places

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from parents disillusioned with the state schools. But his heart also went out to the children in his community and from his church—how could he help them better themselves? True, there were the three public schools at the end of the road, but although they were only about a kilometer from where he set up his school, the distance was a barrier for many parents, who didn't want their girls walking down the crowded streets where abductors might lurk. But mainly it was the educational standards in the public school that made parents want an alternative. When they encouraged B.S.E. to set up the school 15 years earlier, parents knew that the teachers were frequently on strike—in fairness to the teachers, protesting about nonpayment of their salaries.

We arrange to meet some parents, visiting in their homes on stilts. The parents from the community are all poor, the men usually fishermen, the women trading in fish, or selling other goods along Apollo Street. Their maximum earnings might amount to about $50 per month, but many are on lower incomes than that. The parents tell us without hesitation that there is no question of where they send their children if they can afford to do so—to private school. Some have one or two of their children in the private school and one or two others in the public school, and they know well, they tell us, how differently children are treated in each. One woman said: "We see how children's books never get touched in the public school." Another man ventured: "We pass the public school many days and see the children outside all of the time, doing nothing. But in the private schools, we see them everyday working hard. In the public school, children are abandoned."

The existence of private schools for the poor provides a grassroots solution to the problem of achieving universal basic education by 2015—without the huge dollops of aid supposedly required.

And of course, Ken Ade Private School is not alone in Makoko. In fact, it is one of 30 private primary schools in the shantytown. I know, because I sent in a research team, graduate students from Nigeria's premier university, the University of Ibadan, to find as many of the schools as they could. In the 30 private schools found, enrollment was reported to be 3,611, all from the slum itself, while the enrollment in the three public schools was reported to be 1,709, but some of these children came from outside Makoko. That is, the great majority, at least 68 percent, of all schoolchildren in Makoko attends private school.

Whether it's in Nigeria or Ghana, which started its own free primary education process in 1996, or India, where free primary education dates back to 1986, in poor areas my researchers found exactly the same story: the majority of poor schoolchildren attend private schools that outperform the state schools for a fraction of the teacher-salary cost.

Not only is the UN backing the wrong horse, it is also missing a trick: for the existence of private schools for the poor provides a grassroots solution to the problem of achieving universal basic education by 2015—without the huge dollops of aid supposedly required. If so many children are in private unregistered schools, then education for all is much easier to achieve than currently believed. Dramatically, in Lagos State, Nigeria, the experts tell us that 50 percent of school-aged children are out of school. My research suggests that it is only 26 percent—the remainder in private unregistered schools, off the state's radar.

But all of this is a success story that's not being celebrated. And perhaps the reasons why are obvious. National governments are threatened by the existence of this counterrevolution in private education, for if they can't get basic education right, then people might wonder: what *can* they do? Aid agencies might wonder whether they have been backing the wrong horse for decades. And development experts feel ideologically snubbed: they believe that the poor need aid channeled through government schools; they're offended that instead, the poor seem to have their own ideas about how educational needs can best be provided. But poor parents know what they are doing. They want the best for their children and know that private schools are the way forward. The question is: will anyone with power and influence listen to them?

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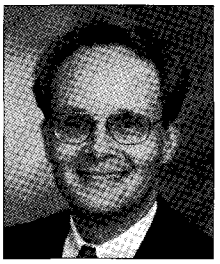

Free-Market Moments on the Silver Screen

BY LAWRENCE W. REED

If you believe in capitalism, going to the movies is all too often a painful exercise. Even those you expect to be apolitical turn up gratuitous dialogue that peddles Hollywood's pervasive but infantile anti-market sentiments. Apparently there's a lot of money to be made criticizing the very marketplace that enables even its most superficial critics to get rich.

On the silver screen, capitalists are usually vilified as greedy and heartless, while statists of every stripe are depicted as selfless, romantic idealists who only want to help people. If it's "private" or "profit"-motivated, it's routinely denigrated. One plot so shopworn it's almost a comedic parody of itself is evil businessmen destroying the environment as crusading politicians fight to clean it up.

In director Ivan Reitman's 1993 flick *Dave*, a presidential look-alike (Kevin Kline), filling in for the incapacitated president, becomes a hero when he sees the light and champions more federal welfare spending. Rare is the film that takes a turn in the other direction, with the hero defending private property, free enterprise, lower taxes, civil society, and other principles that actually improve life and preserve our liberty at the same time.

This is not a trivial matter. Movies and movie stars do more than simply reflect the popular culture; they help shape and move it in certain directions. It takes superhuman special effects to make socialism look good, but Hollywood can make the most preposterous claims look like a documentary.

Just as the broken clock is right twice a day, however, every now and then the film industry produces a memorable moment of dialogue—and once in a blue moon, even an entire movie—that breaks the mold. What follows is a tiny sample of my favorites, from just four films.

The same Ivan Reitman cited above also directed *Ghostbusters* in 1984. Four parapsychology cranks finally are tossed out on their ears from cushy jobs at a state university. Lamenting their predicament, one of them suggests going into business for themselves. Dr. Raymond Stantz (Dan Aykroyd) expresses his reservations this way: "Personally, I liked the university. They gave us money and facilities. We didn't have to produce anything. You've never been out of college. You don't know what it's like out there. I've worked in the private sector. *They expect results!*"

In one brief utterance, Stantz enshrined a cardinal rule of economics in the minds of millions of fans, and no one wondered what he meant. No firm in a free market can long afford to squander its resources on products of dubious value. The tax-funded public sector, however, is another animal altogether. The movie's villain, by the way, is an arrogant control freak from the EPA whose order to release the spirits incarcerated by the Ghostbusters crew wreaks havoc on New York City.

Ron Howard's *Cinderella Man*—a nominee for three 2005 Oscars—is a masterpiece from start to finish, but I especially love an early scene in which boxer James Braddock (Russell Crowe) learns that his young son has stolen a sausage. The family is hungry and destitute at the bottom of the Great Depression. The boy was fearful that, like one of his friends whose parents couldn't provide enough to eat, he would be sent to live with relatives who could afford the expense. Braddock does not hesitate on the matter for a second. He immediately escorts the boy to the store to return the sausage and apologize to the butcher. He then lectures his son:

"There's a lot of people worse off than we are. And just because things ain't easy, that don't give you the excuse to take what's not yours, does it? That's stealing, right? We don't steal. No matter what happens, we don't steal. Not ever. You got me?"

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His son replies, "Yes," but Braddock presses the point, two more times: "Are you giving me your word?"

"Yes."

"Come on."

"I promise."

Poverty is no excuse to steal? Private property defended by people who have almost none? Such time-honored, virtuous notions were once commonplace in America, but when Hollywood presents them in a powerfully positive way, it's truly a Kodak moment. Braddock's heroism ascends to new heights later in the film when he does what no welfare recipient is ever asked to do and what perhaps not one in a million has ever done: He pays the taxpayers back.

France doesn't produce many nonsocialists these days, but if his 2001 film *Enemy at the Gates* is any indication of his political views, director Jean-Jacques Annaud has a big problem with socialism.

By the fall of 1942 two socialist titans—Nazi Germany and the communist USSR—were locked in a death grip around Stalingrad, a city on the Volga and the backdrop to the movie. At center stage is a duel between two snipers—the Russian sharpshooter hero Vassili Zaitsev (Jude Law) and the Nazi marksman Major König (Ed Harris), sent by Hitler to kill him. What the film has to say about the Soviet Union in general and Marxism in particular is almost breathlessly bold for today's run-of-the-mill leftist filmmaker.

Josef and Adolf

Once the Nazis realize the propaganda value to the Russians of Zaitsev's superb skills with a rifle, König is dispatched to eliminate him. Zaitsev is assigned a bodyguard (played by Ron Perlman) who, during a momentary lull in the shooting, tells his comrade of a revealing experience. He spent 16 months in Germany before the war ("when our Josef and their Adolf were walking hand in hand," as Perlman puts it). Back in the USSR later, he was thrown in prison. His teeth were punched out because when asked by interrogators why he'd been in Germany, he explained—truthfully—that Stalin had sent him there. Perlman's character concludes, "That's the land of socialism and universal bliss for you."

My favorite moment came near the end of the film, just before a Soviet propagandist named Danilov (Joseph Fiennes) heaves himself into the line of fire. Disillusioned with the cause he's been fighting for and disgusted with himself for having betrayed Zaitsev, he mutters, "We tried so hard to create a society where everyone was equal, where there was nothing to envy or appropriate. But there is no 'new man.' There will always be envy. There will always be rich and poor." Danilov was not speaking in purely materialist terms. Next he says, "Rich in gifts, poor in gifts. Rich in love, poor in love."

Egalitarians in general, and Karl Marx in particular, took it on the chin with that line. In *Enemy at the Gates* you get none of the numbskull, politically correct romanticization of Marxism that Hollywood shamelessly gave us 20 years before in Warren Beatty's lamentable *Reds*.

Mel Gibson's *The Patriot* (2000) features Gibson himself as an American colonist reluctant at first to join the struggle against the king. At a meeting of citizens he resists the call for revolution because he's not convinced that a colonial government would be any better than British rule. He expresses his skepticism with a question that seems especially poignant today, when our own homegrown government taxes more of our earnings than George III ever imagined he could get away with: "Why should I trade one tyrant three thousand miles away for three thousand tyrants one mile away?"

You get the picture. Indeed, maybe a picture ought to be made of nothing but great freedom moments from the silver screen. Short of that, for publication in a monograph longer than space permits here, e-mail me your favorite such moments. If I use your suggestion, you'll be cited.

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Ludwig von Mises: The Political Economist of Liberty

PART I

BY RICHARD M. EBELING

Over a professional career that spanned almost three-quarters of the twentieth century, the Austrian economist Ludwig von Mises was without any exaggeration one of the leading and most important defenders of economic liberty. The ideas of individual freedom, the market economy, and limited government that he defended in the face of the rising tide of socialism, fascism, and the interventionist welfare state have had few champions as clear and persuasive as Mises. He was also the most comprehensive and consistent critic of all forms of modern collectivism. Furthermore, his numerous writings on the political, economic, and social principles of classical liberalism and the market order remain as fresh and relevant as when he penned them decades ago.[1]

Ludwig von Mises

Born in the city of Lemberg in the old Austro-Hungarian Empire on September 29, 1881, Mises came from a prominent family of Jewish merchants and businessmen. His great-grandfather Mayer Rachmiel Mises was honored with a nobility title for his service to the Emperor Franz Joseph as a leader of the Jewish community in Lemberg, a few months before Ludwig was born.[2]

Ludwig's father, Arthur, moved his family to Vienna in the early 1890s where he worked as a civil engineer for the Imperial railway system. Ludwig attended one of the city's leading academic *gymnasiums* as preparation for university studies. He entered the University of Vienna in 1900 and received his doctoral degree in jurisprudence in 1906. In 1909 he was employed by the Vienna Chamber of Commerce, Crafts, and Industry, and continued to work at the Chamber as a senior economic analyst until he left Vienna in 1934 to accept a full-time teaching position at the Graduate Institute of International Studies in Geneva, Switzerland. Besides his work at the Chamber, Mises also taught at the University of Vienna, led an internationally renowned interdisciplinary private seminar, and founded the Austrian Institute for Business Cycle Research in 1927, with a young Friedrich A. Hayek as its first director.[3]

It was during his years in Geneva, between 1934 and 1940, that Mises wrote his greatest work in economics, the German-language version of what became in English *Human Action: A Treatise on Economics*.[4] In the summer of 1940, as the Nazi war machine was finishing its conquest of western Europe, Mises and his wife made their way from Switzerland to the United States, where he spent the rest his life continuing his writings and also teaching for most of those years at New York University, until his death on October 10, 1973, at age 92.

In addition, in both Vienna between the two world wars and then again in post-World War II America, Mises demonstrated a unique ability to attract intellectually creative students around him, thus fostering new generations of scholars to continue the ideas of the Austrian school of economics.

An appreciation of Mises's defense of freedom requires an understanding of the political and ideological trends of the first half of the twentieth century. Throughout most of the nineteenth century, "liberal-

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ism" had meant belief in and devotion to personal freedom, constitutionally limited government, the sanctity of private property, as well as freedom of enterprise at home and free trade among the nations of the world.

But even before World War I many of those who labeled themselves "liberals" were in fact advocates of what a few decades earlier had been called "state socialism" in prewar Imperial Germany. For almost 40 years before World War I, many of the leading German economists, historians, and political scientists—who became widely known as members of the German Historical School—had argued that the socialists had been correct in their criticisms of free-market capitalism. The unregulated market, they said, resulted in an exploitation of the workers and a disregard of the "national interest." Where the socialists had gone wrong, they insisted, was in their radical demand for a revolutionary overthrow of the entire existing social order.

What Germany needed instead, they stated, was "state socialism," under which social reforms would be introduced to ameliorate the supposed "excesses" of unbridled laissez faire. The German Historical School supported and encouraged the imposition of the modern welfare state by the German "Iron Chancellor," Otto von Bismarck, in the 1880s and 1890s. Socialized medicine, state-managed old-age pensions, minimum-wage laws, and government-sponsored public housing and recreational facilities would provide "cradle to grave" security for the "working classes," and would thus lure them away from the more-radical proposals of the Marxian socialists.[5]

At the same time, government regulation of industry and agriculture through tariffs, cartels, and subsidies, as well as production and price controls, would assure that the activities of the "capitalist class" would be harnessed to what the political authorities considered to be in the "national interest." Pragmatism and expediency in all economic and social policy decisions were hailed as the highest forms of political wisdom and "statesmanship," in place of "inflexible" constitutional restraints that limited the discretionary power for government intervention.

Members of the German Historical School argued that old-fashioned classical liberalism had been purely "negative" in its understanding of freedom, and in advocating that government's role was simply to secure the lives, liberty, and property of the citizenry from violence, aggression, and fraud. Government, they said, had to be more "positive" and active in providing social safety nets for the masses against the uncertainties of life. Hence, they and their "progressive" followers in England, France, and especially the United States soon were referring to their ideas as a newer and more-enlightened "liberalism," which would create a truer and more complete "freedom" from want and worry.[6] The concept of liberalism, most particularly in the United States, was changing from a political and economic philosophy of individual liberty and free enterprise under the rule of law and limited government, to a notion of political paternalism with an increasingly intrusive hand of government in the social and commercial affairs of its citizens.[7]

> Anticipating the triumph of Hitler and his National Socialist (Nazi) movement in 1933, Mises warned in 1926 that many Germans were "setting their hopes on the coming of the 'strong man'—the tyrant who will think for them and care for them."

Socialism and Nationalism

The last decades of the nineteenth century also saw the growth of two other modern forms of collectivism: socialism and nationalism. Their common premise was that the individual and his interests were always potentially in conflict with the best interests of society as a whole. The Marxists claimed to have discovered the inescapable "laws of history," which demonstrated that the emergence of the division of labor and private property split society into inherently antagonistic social "classes." Those who owned the means of production earned rent and profit by extracting a portion of the wealth produced by the non-owning workers whom the owners of productive property employed in agriculture and industry.

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Eventually this class conflict would lead, through a process of historical evolution, to a radical and revolutionary change in which the workers would rise up and expropriate the property of the capitalists. After having socialized the means of production, the new workers' state would introduce central planning in place of the previous decentralized and profit-oriented production plans of the now expropriated capitalists. Socialist central planning, it was claimed, would generate a level of production and a rising standard of living far exceeding anything experienced during the "capitalist phase" of human history. This process would culminate in a "post-scarcity" world in which all of man's wants and wishes would be fully satisfied, with selfishness and greed abolished from the face of the earth.[8]

The proponents of aggressive nationalism argued that there was, indeed, an inherent conflict among men in the world.[9] This antagonism, however, was not based on social classes as the Marxian socialists defined them. Instead, these conflicts were between nations and national groups. Unfortunately, the nationalist ideologues said, individuals within nations often acted in ways inconsistent with the best interests of the nation to which they belonged. Thus the particular interests of businessmen, workers, and those in various professional groups had to be regulated and controlled for the furtherance of the greater national good. As a result, aggressive nationalism dovetailed—especially, though certainly not exclusively, in Imperial Germany—with the interventionist and welfare-statist policies of state socialism and the newer "progressive" liberalism.

Commercial and military conflict among the nations of the world was inevitable in the eyes of these nationalists. The prosperity of any one nation could only come at the expense of other nations. Hence, the task of all national statesmen was to foster the power and triumph of their own national group through the conquest and impoverishment of others around the world. Since no nation would willingly accept its own political and material destruction, war was an inescapable aspect of the human condition. Militarism and the martial spirit were likewise hailed as both necessary and superior to the "individualistic" and "pacifistic" spirit of production and trade.[10]

The culmination of these collectivist tendencies was the outbreak of World War I in 1914, an analysis of the causes and consequences of which Ludwig von Mises offered in his 1919 volume, *Nation, State, and Economy*.[11] The Great War, as it was called, not only brought forth the triumph of the nationalistic spirit; it also saw the imposition of various forms of socialist central planning as virtually all the belligerent nations either nationalized or thoroughly controlled private industry and agriculture in the name of the wartime national emergency. The governments at war also established welfare-statist rationing and regulation of all consumer production since the needs of total war required total state responsibility for the supposed well-being of entire populations.

Out of the ashes of World War I there arose new totalitarian states, first with the establishment of a communist dictatorship in Russia following the Bolshevik Revolution of 1917 under Lenin's leadership, and then with the rise to power of Mussolini and his Fascist Party in Italy in 1922. Both the communists and the fascists rejected the ideas and the institutions of classical liberalism. Constitutional government, the rule of law, civil liberties, and economic freedom were declared by both these variations on the collectivist theme as reactionary hindrances to the success of, respectively, the worker's state in Soviet Russia and national greatness in Fascist Italy. Both communism and fascism insisted that the individual needed to be "reeducated" and made to conform to the wider socialist or nationalist good. The individual was to be reduced to a cog in the machinery of the all-powerful and all-planning state.[12]

Germany's defeat in the war had resulted in political and economic chaos, which culminated in the disastrous hyperinflation of the early 1920s.[13] Many of the social and cultural anchors of German society were unhinged by the war and the inflation.[14] A growing number of Germans longed for a "Leader" to guide them out of the morass of political instability and economic hardship. In 1925 Mises analyzed these trends in Germany and concluded that they were leading the German people toward a "national socialism," instead of either classical liberalism or Marxian socialism.[15] Anticipating the triumph of Hitler and his National Socialist (Nazi) movement in 1933, Mises warned in 1926 that many Germans were "setting their hopes on the coming of the

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'strong man'—the tyrant who will think for them and care for them."[16]

In later years Mises emphasized that while the Marxists in the Soviet Union used the tools of central planning to culturally redesign a socialist "new man" through various methods of indoctrination and thought control, the National Socialists in Nazi Germany took this a step further with their scheme of centrally planning the racial breeding of a new "master race."[17]

This was the historical context in which Mises published some of his most important works in the period between the two world wars: *Socialism* (1922), *Liberalism* (1927), and *Critique of Interventionism* (1929).

1. On Mises's life and contributions to economics and the philosophy of freedom, see Richard M. Ebeling, *Austrian Economics and the Political Economy of Freedom* (Northampton, Mass.: Edward Elgar, 2003) chapter 3, "A Rational Economist in an Irrational Age: Ludwig von Mises," pp. 61–99; and Richard M. Ebeling, "Planning for Freedom: Ludwig von Mises as Political Economist and Policy Analyst," in Richard M. Ebeling, ed., *Competition or Compulsion: The Market Economy versus the New Social Engineering* (Hillsdale, Mich.: Hillsdale College Press, 2001), pp. 1–85; see, also, Murray N. Rothbard, *Ludwig von Mises: Scholar, Creator, Hero* (Auburn, Ala.: Ludwig von Mises Institute, 1988), and Israel M. Kirzner, *Ludwig von Mises* (Wilmington, Del.: ISI Books, 2001).

2. On Mises's family background and the cultural climate of Vienna and Austria in terms of the Jews and anti-Semitism, see Richard M. Ebeling, "Ludwig von Mises and the Vienna of His Time," Parts I and II, *The Freeman*, March 2005, pp. 24–31, and April 2005, pp. 19–25.

3. On Mises's work as policy analyst and advocate in the Austria of the interwar period, see Richard M. Ebeling, "The Economist as the Historian of Decline: Ludwig von Mises and the Austria Between the Two World Wars," in Richard M. Ebeling, ed., *Globalization: Will Freedom or Global Government Dominate the International Marketplace?* (Hillsdale, Mich.: Hillsdale College Press, 2002), pp. 1–68.

4. Ludwig von Mises, *Human Action: A Treatise on Economics*, 3d rev. ed. (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1996 [1966]).

5. Bismarck told an American admirer, "My idea was to bribe the working class, or shall I say, to win them over, to regard the state as a social institution existing for their sake and interested in their welfare." See William H. Dawson, *The Evolution of Modern Germany*, vol. II (New York: Charles Scribner's Sons, 1914), p. 349.

6. On the ideas and development of the German welfare state and regulated economy in the late nineteenth and early twentieth centuries, see Richard M. Ebeling, *Austrian Economics and the Political Economy of Freedom*, chapter 7, "The Political Myths and Economic Realities of the Welfare State," pp. 179–202, especially, pp. 179–84; and Richard M. Ebeling, "National Health Care and the Welfare State," in Jacob G. Hornberger and Richard M. Ebeling, eds., *The Dangers of Socialized Medicine* (Fairfax, Va.: The Future of Freedom Foundation, 1994), pp. 25–37; see also, Mises's criticisms of the German Historical School in "The Historical Setting of the Austrian School of Economics" [1969], reprinted in Bettina Bien Greaves, ed., *Austrian Economics: An Anthology* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1996), pp. 53–76, especially pp. 60–69.

7. See Richard M. Ebeling, "Free Markets, the Rule of Law, and Classical Liberalism," *The Freeman*, May 2004, pp. 8–15.

8. Mises showed the inherent flaws and contradictions in the Marxian theory of history and class conflict in *Socialism: An Economic and Sociological Analysis* (Indianapolis: Liberty Classics, 1981 [1922; revised eds., 1932, 1951]), pp. 279–320, and *Theory and History: An Interpretation of Social and Economic Evolution* (Indianapolis: Liberty Fund, 2005 [1957]), pp. 102–58.

9. On the evolution and meanings of nationality and nationalism, see Carlton J.H. Hayes, *The Historical Evolution of Modern Nationalism* (New York: Richard R. Smith, 1931); Carlton J.H. Hayes, *Essays on Nationalism* (New York: Macmillan, 1928); Walter Sulzbach, *National Consciousness* (Washington, D.C.: American Council on Public Affairs, 1943); and Frederick Hertz, *Nationality in History and Politics* (New York: Oxford University Press, 1944).

10. Ludwig von Mises, "Autarky and Its Consequences" [1943] in Richard M. Ebeling, ed., *Money, Method and the Market Process: Essays by Ludwig von Mises* (Norwell, Mass.: Kluwer Academic Press, 1990) p. 138: "*Aggressive or militaristic nationalism* aims at conquest and the subjugation of other nations by arms. *Economic nationalism* aims at the furthering the well-being of one's own nation or some of its groups through inflicting harm upon foreigners by economic measures, for instance: trade and migration barriers, expropriation of foreign investments, repudiation of foreign debts, currency devaluation, and foreign exchange control."

11. Ludwig von Mises, *Nation, State, and Economy: Contributions to the Politics and History of Our Time* (New York: New York University Press, 1983 [1919]).

12. See Richard M. Ebeling, *Austrian Economics and the Political Economy of Freedom*, chapter 6, "Classical Liberalism and Collectivism in the 20th Century," pp. 159–78, especially pp. 159–63; on the political and ideological similarities of communism, fascism, and Nazism, see Ludwig von Mises, *Planned Chaos* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1947), pp. 62–79; also see Richard Overy, *The Dictators: Hitler's Germany., Stalin's Russia* (New York: W.W. Norton, 2004); A. James Gregor, *The Faces of Janus: Marxism and Fascism in the Twentieth Century* (New Haven, Conn.: Yale University Press, 2000); François Furet, *The Passing of an Illusion: The Idea of Communism in the Twentieth Century* (Chicago: University of Chicago Press, 1999); and Richard Pipes, *Russia Under the Bolshevik Regime* (New York: Alfred A. Knopf, 1993), pp. 240–81.

13. For Mises's analysis of the Great German Inflation, see his monograph, "Stabilization of the Monetary Unit—From the Viewpoint of Theory" [1923], in Percy L. Greaves, Jr., ed., *Ludwig von Mises, On the Manipulation of Money and Credit* (Dobbs Ferry, N.Y.: Free Market Books, 1978), pp. 1–49, and Ludwig von Mises, "Business Under German Inflation" [1946], reprinted in *Ideas on Liberty*, November 2003, pp. 10–13; also Richard M. Ebeling, "The Great German Inflation," *Ideas on Liberty*, November 2003, pp. 4–5.

14. See Albrecht Mendelssohn Bartholdy, *The War and German Society: The Testament of a Liberal* (New York: Howard Fertig, 1971 [1937]), and Mortiz J. Bonn, *Wandering Scholar* (London: Cohen & West, Ltd., 1949), pp. 273–90.

15. Ludwig von Mises, "Anti-Marxism" [1925] in *Critique of Interventionism* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1996 [1929]), pp. 71–95.

16. Ludwig von Mises, "Social Liberalism," [1926] in *Critique of Interventionism*, p. 67.

17. Mises, *Planned Chaos*, pp. 77–78.

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Japan, Germany, and the End of the Third Way

BY NORMAN BARRY

Last year's election results in Japan and Germany are not only important for those countries but also have wider lessons, for they herald a decisive defeat for a once-fashionable doctrine—the Third Way. This was adopted by socialists in despair of the abject failure of "really existing socialism" but desirous to preserve their anti-capitalist credentials. They assumed we could secure all the benefits of the free market, in terms of its higher productivity and liberal social framework, without its unpleasant concomitants—excessive individualism, companies' concern with shareholder value, the use of the takeover mechanism for industrial reorganization—all summed up by the morally loaded term "greed." Fortunately for Third Wayers there were two economies that apparently evinced different virtues and were highly successful, the second and third biggest economies in the world, Japan and Germany. Indeed, at one time all America was frightened of Japan's stupendous economic virility. The Japanese car industry, spearheaded by Toyota, Nissan, and Honda, was on the brink of taking over from Detroit, and although the Japanese were not great innovators, they could copy and make cars, washing machines, and computers more efficiently than the West. And Germany was the dominant economic power in Europe, whose industries, like Japan's, were heavily geared toward exports. In both countries the shareholders were squeezed out of running companies they nominally owned and industry was geared toward serving the community more than the owners' interests. Thus the huge Japanese corporations played a significant welfare role, and nobody ever lost his job. Even though private ownership was sedulously maintained, Germany and Japan did not have Anglo-American capitalism as exemplified on Wall Street and in the City of London.

But both economies have been mired in recession for the past two decades and have begun to question their own economic models, as was seen in the election results, Japan more than Germany. What went wrong? Briefly, both countries became dominated by interest groups that used the political system to divert income created by others to themselves ("rent-seeking"); both had too much state welfare; and neither economy was flexible enough to cope with the demands of globalization. Overall, Japan and Germany have political systems that offer every incentive for political parties to preserve the current inefficient system and none for anyone who tried to break out of it. It was a classic "social dilemma": everybody knew they would all eventually be better off if they dumped the obstructive labor laws, cramping regulations, and costly welfare, but political parties were beholden to interest groups that benefited from the preservation, indeed expansion, of the prevailing system. Mancur Olson, who analyzed the dilemma in immense detail and sophistica-

Both economies have been mired in recession for the past two decades and have begun to question their own economic models, as was seen in the election results.

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tion once suggested that it could only be overcome by a national catastrophe such as defeat in a major war.[1] And Japan and Germany had their economies devastated by defeat in World War II yet managed to make amazing recoveries in the early postwar years, while among the victors Britain languished until Margaret Thatcher. Britain, of course, was dominated by interest groups, especially trade unions.[2] I shall look at Japan first, and in more detail, because it appears as if it is getting over the aforementioned social dilemma better than Germany.

Japan has had a dominant party, the Liberal Democrats (LDP), which has been out of power only once since 1955, briefly in the 1990s. Yet it has no coherent program. It is really a bunch of pressure groups that profit from the burgeoning state. There is no serious socialism in Japan, and it still has a relatively small public sector, but the Democratic Party of Japan, formed by disenchanted LDP members, is slightly more left-wing and under the influence of trade unions. They know where the rents are.

Prime Minister Junichiro Koizumi of Japan

Japan has always had a market economy, but it was not Anglo-American. Shareholders were paid derisory dividends and kept out of annual meetings; companies were run by "stakeholders," that is, managers and banks. Firms were also more interested in market share than profit, and the whole nation was mobilized to promote exports, not consumption. Companies themselves, if not socialistic, were certainly communitarian: they provided welfare benefits and lifetime employment. It was a rigid and inflexible system, but it worked well enough to make Japan the second biggest economy in the world—until 1990, when the stock market began to fall—from a high of 39,000 on the Nikkei to below 10,000, its nadir. The real economy went into a steady relative decline. Investors originally benefited from capital gains, but millions of Japanese housewives, who had spent the family income buying up stocks, were badly hit by the fall in the 1990s. The country was at the same time building up a huge government debt—now 160 percent of GDP.

Prime Minister Junichiro Koizumi although from an establishment Japanese political family, knew something had to be done if the country were to get out of the stagnation of the 1990s. Japan had been very good at copying Western electronics, but he realized it would have to copy Western economic models too. Elected in 2001, he set his sights on the Japanese postal system. It is not only important in itself, but is also indicative of the Japanese malaise. He wanted to privatize it. His plan was defeated by the upper house of the Japanese Diet (Parliament) early in the summer of 2005 (the lower house had barely approved it), which was the immediate cause of the election.

Privatization was not to improve the delivery of letters and parcels. I can speak from extensive personal experience that, despite being state-run, the postal system is efficient. The real reason for privatizing the post office is that it is also a huge savings bank and provider of nationalized insurance. The Japanese have a legendary propensity to save, and they tend to put their savings in the post office—at present it controls assets of $3 trillion. And where does that money go? It funds huge and mainly unnecessary public works. There is a medium-sized town near Tokyo that has two airports, which together have ten flights a day. All this is a gift to the LDP, which benefits from the useless jobs and wheels out the votes at election time. The post office has 400,000 employees. What Koizumi wants to do is to free up all this capital to be invested in the still-productive private sector.

Of course, all this upset the LDP establishment, and it defeated Koizumi's first attempt at privatization. But he daringly called an election last September, fired dissident LDP members, and sent in "assassins," handpicked glamorous media personnel, to fight them at the election. He won an overwhelming victory: even if the upper house continues to oppose post-office privatization, he has enough votes from the lower house, with his coalition partners, the Komei, to use the constitution and override it.

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Public Choice Defied

Koizumi's victory was remarkable because it defied the lessons of Public Choice theory: it is normally impossible to defy an electorate that consists largely of rent-seekers. The future benefits of necessary reform are insufficient to compete with the attractions of short-term advantage. But Koizumi is an astute, possibly honest, politician, and he campaigned as if the election were a referendum on the privatization. If he had run on a regular manifesto it is almost certain his opponents could have defeated him on a rent-seeker's program. He also has some charisma, unusual in Japanese politics.

But progress is likely to be slow in Japan—the privatization is not scheduled for completion until 2017. And the rent-seekers are likely to defeat him if he tries to reform the costly welfare system. The immediate problem is that Japan has an aging population and a declining workforce. That will also bring forth the need for increased health expenditure. Furthermore, Koizumi has to leave his post by next September; the LDP rules limit the leadership of the party to two terms, and there does not seem to be anybody with the drive and commitment to reform to take his place. However, there are already moves underfoot to persuade him to carry on. If Japan is to continue to defy the well-established theorems of Public Choice, the country will need somebody of his determination.

Ludwig Erhard (1897–1977)

Germany

Germany has the world's third biggest economy, and it has gone through an experience not unlike Japan's. From being the powerhouse of Europe the economy is now almost shrinking, with over 11 percent unemployment. After World War II Germany established the "social market economy" under Ludwig Erhard, first as finance minister, then (unsuccessfully) as chancellor.[3] The "social market economy" seemed to combine market-led economic progress with compassionate welfare policies, though in the last 30 years the social element has inexorably displaced the economic element in the model. (It is not at all clear that Erhard himself would have approved of this.) The original Bismarckian welfare state was extended, first to expanded pensions (unfunded and dependent on a rising birth rate) and then to conditions of employment. But the German birth rate has dramatically fallen; private pensions are virtually nonexistent; and rising nonwage labor expenses have made the costs of doing business unsustainable—much German capital is leaving the country. This can only worsen under globalization. German business is like Japan's, with powerless shareholders. Takeovers are rare.

All this has been known for a long time, but entrenched interest groups made the political system more or less immobile. No political party dare risk offending these groups with serious reform. The parties are in an unconscious cartel, but while cartels are normally overcome in private competitive markets, it is not so easy in the ersatz competition of representative democracy. Germany is in an insoluble social dilemma, and Erhard has been virtually forgotten.

Some progress was made, however, with the emergence of Angela Merkel as leader of the Christian Democratic Union (CDU). Unable to form even a tiny majority in alliance with the small but more free-market Liberal Democratic party, Merkel has been forced into a "grand coalition" with the Social Democrats. That means the same interest-group immobility will continue for some time. A good example is tax reform. Merkel's projected finance minister is an obscure academic, Paul Kirchhof, who achieved notoriety by suggesting replacement of the complex German tax system, with its myriad exemptions, with a lowish flat tax of 25 percent. Immediately all those groups that benefited from the prevailing system protested and the scheme was quietly forgotten during the campaign. No German commentator seemed to realize that a carefully designed flat tax will actually increase government revenue through less tax avoidance and tax evasion, and the operation of the Laffer curve. A flat tax is not just for the rich, but benefits everybody, except tax accountants. It is a way of getting over the social dilemma.

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Frau Merkel has suggested that laws on hiring and firing will be relaxed so that it will be easier to dismiss redundant workers, and her welfare reforms would remove the temptation not to work, the bane of German welfare policy. However, even the Social Democrats under Gerhard Schroeder offered tame versions of these policies, only to water them down even further after relentless opposition from Germany's still powerful trade-union movement. Of course, Germany has certain unique problems, especially the cost of reunification, but this should not distract us from the fact that the country illustrates all too well the universal problems of representative democracy, especially the ability of entrenched groups to prevent the pursuit of the genuine public good.

The experience of both Japan and Germany should alert us to the seductive but ultimately lethal properties of the Third Way. By locking ever more people into the state, especially through generous welfare policies, it only strengthens powerful interest groups and makes reform almost impossible. Perhaps only by the Swiss system of referenda on particular issues can the dilemma be got round. Indeed, the fact that Koizumi almost turned the Japanese election into a referendum on the post-office privatization supports this position. It is possible that if the flat tax were put to a referendum in Germany it would be approved.

As the president of the Czech Republic, Václav Klaus, once famously said: "The Third Way is the Third World."

And by restricting the power of shareholders the Third Way weakens the corrective mechanisms of the market and strengthens the managements of companies and banks, neither good defenders of free markets. There is only one form of successful capitalism, that is free-market exchange with a very limited state. As the president of the Czech Republic, Václav Klaus, once famously said: "The Third Way is the Third World." Japan, which is on its way to recovery, might have resisted Public Choice temporarily, but Germany certainly has not.

1. See Mancur Olson, *The Rise And Decline of Nations* (New Haven, Conn.: Yale University Press, 1982).
2. See Norman Barry, "What Kind of Conservatism?" *Margaret Thatcher's Revolution*, ed. Subroto Roy and John Clarke (New York: Continuity Books, 2005).
3. See Norman Barry, "The Social Market Economy," *Social Philosophy*, vol. 10, 1992.

The Price of Security

The desire for security, while in itself natural and legitimate, can become an obsession which ultimately must be paid for by the loss of freedom and human dignity—whether people realize it or not. In the end, it is clear that whoever is prepared to pay this price is left neither with freedom and dignity nor with security, for there can be no security without freedom and protection from arbitrary power. To this exorbitant price must be added another . . . namely, the steady diminution of the value of money. Surely, every single one of us must then realize that security is one of those things which recede further and further away the more unrestrainedly and violently we desire it.

—Wilhelm Röpke, *A Humane Economy*

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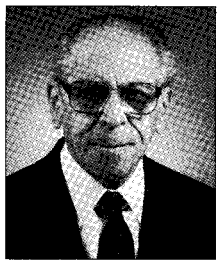
Mental Illness as Brain Disease: A Brief History Lesson



BY THOMAS SZASZ

A 1999 White House Conference on Mental Health concluded: "Research in the last decade proves that mental illnesses are diagnosable disorders of the brain." President William Clinton was more specific: "Mental illness can be accurately diagnosed, successfully treated, just as physical illness." Persons who reject the view that mental illnesses are physical diseases are dismissed by today's opinion-makers as intellectual troglodytes, on a par with "flat-earthers."

That the claim that "mental illnesses are diagnosable disorders of the brain" is a lie ought to be evident to anyone who thinks for himself. Here I want to show that the claim that "research in the last decade proves [this]" is also a lie, one more in a very long list in the history of psychiatry. The contention that mental illness is brain disease is as old as psychiatry itself: it is an integral part of the grand lie that psychiatry is a branch of medicine and healing, when in fact it is a branch of the law and social control. Hannah Arendt was right when she observed: "There are no limits to the possibilities of nonsense and capricious notions that can be decked out as the last word in science."

The contention that mental illness is brain disease is as old as psychiatry itself: it is an integral part of the grand lie that psychiatry is a branch of medicine and healing, when in fact it is a branch of the law and social control.

The idea that mental illness is a bodily disease dates back to the premodern medical conception of disease as "humoral imbalance," comically prefiguring the modern, supposedly scientific conception of it as "chemical imbalance." In the United States, the idea of mental illness as humoral imbalance was famously espoused by Benjamin Rush (1746–1813), the founding father of American psychiatry. Rush did not discover that certain behaviors are diseases; he decreed that they are: "Lying," he declared, "is a corporeal disease." In a letter to his friend John Adams, he wrote: "The subjects [mental diseases] have hitherto been enveloped in mystery. I have endeavored to bring them down to the level of all other diseases of the human body, and to show that the mind and the body are moved by the same causes and subject to the same laws."

In the nineteenth century the scientific concept of disease as lesion replaced the Galenic concept of disease as humoral imbalance. Now, physicians postulated that mental diseases are diseases of the brain. From about 1850 until past World War I, German (more precisely, German-speaking) psychiatry ruled the field. The very term psychiatry (*Psychiatrie*) was a German invention, coined in 1808 by Johann Christian Reil (1759–1813). Reil, not an alienist (psychiatrist), was one of the outstanding medical scientists and physicians of his age. He was a friend and physician of Johann Wolfgang von Goethe. In addition to coining the term "psychiatry," he also coined the term "noninjurious torture," to describe the methods of frightening mental patients that he considered effective and legitimate "treatments."

It is important to keep in mind that the German asylum system was created, in 1805, by the autocratic Prussian state: specifically, by Karl August von Hardenberg (1759–1822), a Prussian statesman. Hardenberg declared, "The state must concern itself with all institutions *for*

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those with damaged minds, both for the betterment of the unfortunates and the advancement of science. In this important and difficult *field of medicine* only unrelenting efforts will enable us to carve out advances for the good of suffering mankind. Perfection can be achieved only in such institutions."

Writing in 1917, at the height of World War I, Emil Kraepelin (1856–1926)—creator of the first system of psychiatric classification, today widely considered the father of modern "scientific" psychiatry—offered these revealing remarks about Hardenberg's achievement: "The great war in which we are now engaged has compelled us to recognize the fact that science could forge for us a host of effective weapons for use against a hostile world. Should it be otherwise if we are fighting an internal enemy seeking to destroy the very fabric of our existence?"

Kraepelin's remarks make clear that he regarded psychiatry as an arm of the state, similar to the military forces, whose duty is to protect the fatherland from "an internal enemy" that, like a hostile army, seeks to destroy it. The evil genius of psychiatry lay, and continues to lie, in its ability to convince itself, the legal system, and the public that, in matters defined as psychiatric, there is no conflict between the legitimate interests of the individual and the legitimate interests of the political class in charge of the state.

Of course, the German psychiatric pioneers had to answer the question, "What is mental illness?" Answer it they did. Wilhelm Griesinger (1817–1868), considered one of the founders of German psychiatry—and also of the famed Zurich insane asylum, the *Burghölzli*—declared: "Psychological diseases are diseases of the brain. . . . Insanity is merely a symptom complex of various anomalous states of the brain."

Theodor Meynert (1833–1892)—a German-born Viennese neuropsychiatrist and one of Freud's teachers—began his textbook, *Psychiatry* (1884), with this statement: "The reader will find no other definition of 'Psychiatry' in this book but the one given on the title page: *Clinical Treatise on Diseases of the Forebrain*. The historical term for psychiatry, i.e., 'treatment of the soul,' implies more than we can accomplish, and transcends the bounds of accurate scientific investigation."

In a review of Swedish psychiatry in the nineteenth century, historian of science Roger Qvarsell states: "In the 1860s, the debate among psychiatrists about the real nature of mental disease was over. . . . Almost all medical scientists and medical authorities were at this time convinced that mental diseases were of the same nature as somatic disorders." *Plus ça change, plus c'est la même chose.*

Infringement of Freedom

What inferences did and do doctors draw from their concepts of mental illness as brain disease? First, as Carl Wernicke (1848–1905), a prominent nineteenth-century German neuropsychiatrist observed, "The medical treatment of [mental] patients began with the infringement of their personal freedom." In addition, it began with "benevolent tortures," such as frightening them by throwing them into a pit of snakes, the origin of the term "snake pit" for insane asylum. More specifically, the humoral-imbalance theory led Rush to employ "bleeding, purging, low diet, and the tranquilizing chair." The tranquilizing chair was a chair-like contraption for confining the patient and rotating him until he became dizzy or lost consciousness. This was supposed to rebalance the circulation in the brain. It was but a small step from the nineteenth century's tranquilizing chair to the twentieth century's tranquilizing drug, supposed to rebalance the chemical imbalance in the patient's brain.

Psychiatric practice today requires that doctors and patients ignore evidence and be ignorant of history. There was no evidence for a humoral imbalance causing illness, but the doctrine prevailed for two thousand years. There is no evidence for a chemical imbalance causing mental illness, but that does not impair the doctrine's scientific standing or popularity. Neither the American Psychiatric Association nor American presidents remind people of the caveat of the great nineteenth-century English neurologist John Hughlings Jackson (1835–1911): "Our concern as medical men is with the body. If there be such a thing as disease of the mind, we can do nothing for it."

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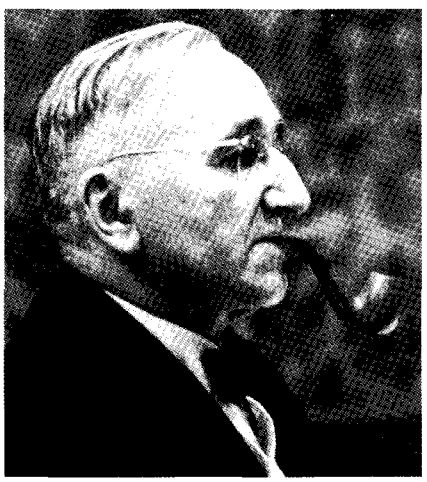
Hayek and Freedom

BY STEVEN HORWITZ

A few years ago I had the opportunity to look through a transcription of a set of note cards that F.A. Hayek kept through the latter years of his life. It was fascinating to see how he wrote for himself and to get glimpses of ideas that would later be more fully fleshed out. One theme that emerges in those cards, and that has been pervasive over Hayek's career, is his understanding of freedom. It is a nuanced and sophisticated conception of human freedom that differentiates itself from the ways the term is used by the left and the right. Classical liberals should understand Hayek's view of freedom, and its connection to tradition and the coordinating role of institutions, to avoid the problems that confront other conceptions of freedom.



F.A. Hayek (1899–1992) FEE Archives

Hayek's conception is perhaps best captured by this note: "Restraint is a condition, not the opposite of freedom." He expands on this idea: "The basis of freedom as well are [sic] the restraints commonly accepted by the members of the group in which the rules of morals prevail. The demand for 'liberation' from these restraints is an attack on all liberty possible among human beings." And perhaps most tellingly: "Freedom is order through law." For Hayek, freedom is not the absolute liberty to do as one pleases, rather it is the recognition of the necessity of law and morality in order to ensure that human interaction is cooperative and orderly. In some sense, this is the theme that underlies his life's work: human cooperation, social order, and economic prosperity are only possible where human freedom is maximized, subject to the constraints of a legal and moral code that demarcate the realms of mine and thine.

Hayek's more narrow work within economics furthers this larger notion of freedom. The competitive process of the market is seen as enhancing human cooperation and prosperity by providing a network of institutions that both bound human choice within the rule of law and enable market actors to freely express their preferences within those boundaries. Freedom of action within the law gives rise to market phenomena such as prices and profits, both of which make the private knowledge of actors socially accessible to others, which in turn generates economic coordination. More specifically, this market freedom is linked to our ignorance: we need freedom within the law not because we know what to do and freedom allows us to do it, but because we are *ignorant* of what to do and freedom allows us to discover the best ways of doing things. As Hayek says elsewhere in those note cards: "Competition is the only way to show error and therefore lead to wisdom" and "It is in a great measure competition which has made cooperation possible." By enabling us to learn from one another, the competition resulting from freedom reveals our ignorance, provides the knowledge and incentives to correct that ignorance, and furthers the process of human cooperation and social order. It is therefore no surprise that Hayek's pre-

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ferred political system was one in which constitutional restraints on the political process limit its ability to intervene in ways not bound by the rule of law.

This conception of freedom is in stark contrast to that often found on the left. For many on the left, freedom is equivalent to "liberation," particularly liberation from the institutions and morals that frame Hayekian freedom. This demand for liberation is, of course, historically part of socialism and the demand for social justice via redistribution. The "fatal conceit" behind planning has always been that human reason could organize economic resources better than obeying the restraints of market institutions could. On the softer left the demands for social justice imply that some humans must be freed from the rule of law so they have the power to determine who is deserving of what and to command the resources necessary to provide it to them. In these economic contexts the left's conception of freedom has always been one that involves liberation from the institutions of "several property" and the rule of law.

The "fatal conceit" behind planning has always been that human reason could organize economic resources better than obeying the restraints of market institutions could.

For many on the New Left, and for modern-day cultural critics, the demand for "freedom" is not so much about economic institutions but social ones. Whether it be in the form of race, gender, or sexuality, the complaint of the cultural critics is that liberal institutions suffocate "genuine" freedom by the noncoercive enforcement of social norms and practices (traditions). For example, the fact that existing economic and social institutions generate difficult choices for mothers who wish to work is seen to be evidence of a lack of "freedom" and such institutions are referred to as "repressive" and the like.

Perhaps the best example of these conflicting notions of freedom is the use of the term "deconstruction." Although Hayek was surely unafraid to criticize existing institutions and to question who the real beneficiaries of such institutions were (see his attacks on unlimited democracy), he recognized that it was not possible to remove such institutions completely and replace them with something brand new. The word "deconstruction" carries with it the implication that the institutions in question *were* "constructed" in some meaningful sense and that they *can be* "reconstructed" to better address the problem at hand. Hayek's work gives us powerful reasons to suspect that social institutions were not intentionally constructed to benefit particular groups and that such institutions could not be reconstructed to serve new purposes. Whatever freedom might mean, it cannot mean total liberation from existing institutions or the power to reconstruct them as one sees fit. For Hayek, such a notion of freedom is self-contradictory: "The enemies of the discipline of rules are the enemies of freedom."

No Comfort for the Right

That having been said, Hayek's conception of freedom should not provide much comfort to those on the right for whom freedom is very tightly tied to a reverence for tradition. It is certainly true that he had great respect for tradition and for the institutions that have emerged through long social-evolutionary processes. However, he also recognized that these processes do not ossify and that social evolution continues. Social institutions can and should evolve in ways that respond to genuine cases of maltreatment (for example, the abolition of slavery in the United States and the reformation of property laws to provide equal treatment for married women). He is also adamant, in contrast to the caricature of him often offered, in arguing that what has evolved is not automatically good. As one of the note cards reads: "Tradition is not good simply because it is tradition. It is for what it has given us and only so long as an alternative does not prove by its effect that it is better." In earlier work Hayek emphasized that it is the job of the social scientist to hold up each and every social institution to critical scrutiny, but that one cannot critically scrutinize *all* social institutions at once. So his attitude toward tradition is rightly characterized as "respectful" but not "reverent."

Unlike true conservatives, who see in both the pres-

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ent and the past, traditions to be recaptured and preserved at almost any cost, Hayek recognizes that society is the product of continuing evolutionary processes that are unintended consequences of the choices and values of the humans who constitute them. Attempting to "flash-freeze" the social order of either some mythical golden past or some salvageable present, closes off the learning process of cultural evolution. Hayek's note on this subject reads: "The eternal conflict between preserving tradition, the product of the evolution of the past, and keeping the way open for further evolution. The Conservative defender too inclined to treat as ultimate wisdom what by the same token is bound to be superseded."

Thus despite his trenchant criticisms of the left and its conception of freedom, Hayek is ultimately not a conservative (as, of course, he himself argued in 1960). The evolution of social institutions and practices is not to be automatically regarded as problematic from a Hayekian perspective. All such changes should of course be carefully analyzed, but should hardly be rejected out of hand simply because they aren't the way it's always been done. For Hayek, what matters is whether the institutions in question are performing a valuable function, not whether they perform the same function they always have, or whether they take the same form we have always known.

And this argument comes back to Hayek's conception of freedom. It is not just a matter of obeying restraints at all costs. Rather, Hayekian freedom recognizes that by obeying such restraints in general, we open up space to reflect critically on particular restraints and, in so doing, challenge them. Hayek's notion of freedom includes room for differentiation and experimentation: "Majority opinion must act as a restraint but not as a guide to individual action—all advance has been due to individual views in conflict with majority opinion" and "It must be admitted that culture is something we must in the first instance conserve but cannot make. But we must and can as individuals endeavor to improve it." Hayekian freedom is a freedom that emerges from, but is not completely limited by, legal and moral restraints. It is a freedom that recognizes both the functional value of evolved traditions and the importance of the differentiation and innovation that drive all evolutionary processes. In recognizing both dimensions of freedom, Hayek's conception of freedom is superior to the conceptions found on both the left and right.

Why I Am Not a Conservative

That the conservative opposition to too much government control is not a matter of principle but is concerned with the particular aims of government is clearly shown in the economic sphere. Conservatives usually oppose collectivist and directivist measures in the industrial field, and here the liberal will often find allies with them. But at the same time conservatives are usually protectionists and have frequently supported socialist measures in agriculture.

—F.A. Hayek, "Why I Am Not a Conservative," 1960

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On Misplaced Concreteness in Social Theory

BY JOSEPH R. STROMBERG

The following piece will not be as abstruse as its title suggests. Rather, it results from the simple observation that, time and time again, some harmful outcome or process commonly attributed to the everyday workings of the market economy actually does exist, but it exists in the realm of the government and politics. Politicians and their friends really ought to be giving us some answers in light of these ills.

The line of attack might be seen as an application of Bastiat's "broken window" fallacy. As Murray Rothbard warned us, there are a great many "broken window fallacy mongers" about. If nothing else, their activities will keep us on our toes. A handful of examples may suffice and should help demonstrate that a basic understanding of economic principles is critical if we are to understand important causal connections in history and politics.

Let us begin with something that is supposed to be good: the much-heralded Keynesian "multiplier effect." This is a second-level broken-window fallacy. Here a sophisticated fallacy-monger arrives, just after the free-market economist has dispelled a first-order fallacy by expounding the "seen" versus the "unseen." The secondary fallacy-monger then says, "Oh sure, that sounds good, but there are many things the free-market economist hasn't told you."

One such thing is the joyous world of the multiplier. This holds that any money invested in productive enterprises will stir up great waves of activity throughout the economy at some mathematically constant rate, resting on some functional relationship between big economic aggregates (consumption, investment). Therefore, the state ought to expand the money supply (inflate) to make additional money available. At the end of the happy process, to paraphrase an old song, the solar radiation will be unwontedly great and there will be no precipitation.

Austrian-school economist Rothbard performed a great takedown of this notion with his suggested "personal multiplier." Faithfully following the mathematical form of the multiplier principle, he "proved" by reductio ad absurdum that a sum of money given to any reader of his book would, when spent, "prime the pump of a 100,000-fold increase in the national income."[1]

> It seems that states are generally driven to expand in a way that business is not. Business competition is not very much like war at all, except in the realm of bad metaphors.

So it appears the Keynesian multiplier is a theoretical bust. There is, however, a *bureaucratic* "multiplier effect." Political scientist Tom Burns writes that kings created bureaucracies so as to govern more effectively and in time found themselves displaced by these officials. Republics and, later, democracies inherited the bureaucracies and ran with them.

As a result, civil society now exists only "as a vast residue from which power and authority have been extracted and distilled into sovereignty." This works for

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the state because "Renaissance bureaucracy"—the ancestor of modern bureaucracies—"was a great chain of command" and "[d]ispersing sovereign power through the many chains of command of a bureaucracy multiplies power."

Burns quotes the German sociologist Niklas Luhmann: "Thus power takes on a hierarchic, i.e., reflexive, form in order to be able to accomplish a multiplicity of influences simultaneously. . . . This extension of power is put through with the aid of such actions as representation, transfer or delegation, which quite innocently suggest that the power which is being exercised remains what it was, while they actually multiply its effectiveness." Luhmann adds: "To apply power to the reinforcement of power amplifies the total power available in a social system, by means of a sort of relay technique."[2]

So there is a multiplier effect and, even if it isn't mathematically constant, the state can answer for it.

Then there are claims about "cutthroat," or "predatory," competition in business, which is said to lower the moral tone of society and yield sundry zero-sum games. But competition can involve degrees of voluntary cooperation within an industry, friendly relations between competitors, or it can run to personal rivalries, depending on the personalities involved. It need not become a serious problem until or unless one party *brings in the state* to strengthen his hand. Even a businessman who loses out to competitors is not annihilated; he can find other work in the same industry or try his hand at something new.

In some cases, fierce competition with outbreaks of violence may arise where property rights are unclear or unenforced, as in the famous "wars" in the Old West between the ranchers and the farmers, not to mention the beleaguered sheep herders. These conflicts were fairly manageable, however, compared to real, *eliminative* competition between states, which we call war. In these competitions, which are indeed predatory, one state may cease to exist altogether, or lose territory to another state.

Economist Jörg Guido Hülsmann has proposed a political "progression theorem." He argues that states are driven to expand territorially, when possible, in order to gain more revenue, in order to expand further, gain more revenue, and so on. The drawback is, as noted, that losing a major war can mean the "death of a state" (to use Rothbard's phrase). After two destructive world wars, European states still seek to enlarge their incomes, but having reached the limits of politically feasible taxation, they must enhance their revenues indirectly through inflationary fractional-reserve banking and public debt. As each central bank reaches *its* limits of monetary expansion, each state's only hope is to have some even higher jurisdiction prop up its money (since the whole point has been to evade the normal penalties markets finally inflict on counterfeiters).

Expansion by Stealth

With war off the agenda, the bureaucracy of the embryonic pan-European state tries to expand its revenues and jurisdiction by peaceful, indirect means—more carrot than stick—by conning additional states into entering the EU,[3] while deliberately failing to address fundamental "constitutional" questions such as withdrawal from the union, an expansion by stealth that nicely recapitulates the strategy of the Federalists in the United States in 1786–1787.

Historians Bruce Porter, William Hardy McNeill, Charles Tilly, and many others have treated eliminative state competition, with its attendant wars, as the main engine of rapid state building.[4]

Thus an inherent, irrational growth dynamic attaches to states. Businesses, unlike states, know when to quit expanding because of the inbuilt profit-and-loss test. States can be said to expand "irrationally" because they have no such test, in part because the costs involved are not paid by the decision-makers themselves. Their only risk, as noted, is gambling and losing in some armed struggle with another power. This may be a restraint, but it is not as decisive as red ink on the quarterly report.

This is not to say that a state will always and continuously strive to expand externally. A state may be unable to extract sufficient resources from production, and cultural factors may intrude as well. A state unable to expand outward will certainly be tempted to make more work for itself at home. Successful states like the United States may do both simultaneously. In the case of a successful imperial state, a real synergy can get underway through institutional "blowback" from overseas policing methods, and such.

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However we may sort this out, it seems that states are generally driven to expand in a way that business is not. Business competition is not very much like war at all, except in the realm of bad metaphors. Of course if the state's regulatory branches shape the environment in certain ways that spread moral hazards everywhere, we can have something like the savings-and-loan scandal of the 1980s. But that came to an end when the free ride ran out; even here the message *to quit* arrived sooner than such messages seem to come to the state.

While on the subject of irrational growth, I should at least mention the complaints made in the 1940s that the market economy, because of inbuilt defects, could not produce enough growth, whereas Soviet communism doubtless could do so. By the late 1950s the complaint was that there was "too much" growth. Such shifts in attack suggest there is much truth to the famous comment of Joseph Schumpeter that, as far as most intellectuals are concerned, the guilty verdict against the market is already in, although the details of the indictment may change.[5]

One more item might be mooted before we leave the topic of competition and war. It is that militarism itself generates high time-preference and lowers the social (market) rate of saving.[6] In her essay "The Iliad as the Poem of Force," Simone Weil remarks in passing on the severe foreshortening of time as the fight-keen Achaeans approached Troy. Not knowing how much longer he may live, each Greek's value-scale shifted dramatically toward present consumption and away from concern for the future.[7] It is almost superfluous to mention the seedy material culture near any large military base, with pawn shops, strip clubs, and the like, as the dominant businesses.

The Inevitable Trend Toward Monopoly

The idea of an inherent expansionist dynamic brings us to the claim that competitive capitalism inevitably means the "eating up" of smaller enterprisers and the rise and persistence of giant private "monopolies." This charge has been kicking around since the late nineteenth century in the United States, and the failure to address it adequately has led to all manner of historical misunderstanding and bad legislation. Rothbard did address the matter, rather conclusively.

In a hundred-page tour de force,[8] Rothbard reduced "monopoly" to its proper bulk and resurrected Lord Coke's seventeenth-century definition of monopoly as "*a grant of special privilege by the State, reserving a certain area of production to one particular individual or group.*"[9] On this understanding, without legal-political barriers to entry even the largest business is not a monopoly; it is simply very good at satisfying the consumers and/or unchallenged by good competitors for the moment. But there *is* genuine monopoly: first, the state itself, which asserts a monopoly of initiating force within a given territory; second, enterprisers working under a grant of exclusive privilege from the state.

Here is how Rothbard describes the evils of monopoly:

> All the effects that monopoly-price theorists have mistakenly attributed to voluntary cartels, therefore, *do* apply to governmental monopoly grants. Production is restricted, and factors are released for production elsewhere. But *now* we can say that this production will satisfy the consumers less than under free-market conditions; furthermore, the factors will earn less in the other occupations.[10]

Once again, a problem said to arise on the market is to be found in the orbit of the state.

The Market Fosters Disorder and Social Disruption

The charge here is that the market economy, as such, leads to social disruption, social decay, "atomization" of society, alienation, and the rest. The decline of small towns and businesses will be highlighted. We are all doomed, it seems, to deal endlessly with dizzying and unwanted "social change." The critics of course often have their own list—of desirable social changes—to be imposed by the state, but that is another matter.

Everyone from the tamest "liberal" centrist to the wildest Marxist or feudal reactionary feels free to make these charges. Paul Baran and Paul Sweezy's fundamentalist-Marxist tract, *Monopoly Capital*, which blamed literally everything deplorable in American life on late, or "monopoly," capitalism, is just a sample of this genre.[11] Nice work, if you can get it; but it seems likely that these critics don't have the right target in their sights.

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I now introduce the Interstate Highway Theorem. It flows from the safe assumption that no capitalist or consortium of capitalists would have risked their own money on this "eighth wonder of the world." The theorem simply states that, on their own, free-market participants would never have put together such a highway system, and of course they did not. We would have had roads of some kind, but not this particular public-goods boondoggle.

The interstate highways grew out of congressional pork-barrel politics and Cold War military-industrial considerations, and were popular because they "made work" for certain contractors and allied unions. Any losses to small towns, or to picturesque American ways of life dependent on those towns, caused by the building of interstates may be addressed to whatever federal departments presided over their construction, enforced eminent domain on wicked "hold-outs," and subsidized the usual corporate suspects to build those roads. They may not be addressed to the free market.

Another aspect of this alleged problem is the claim that social conditions in market-based societies render people "inauthentic," cutting the ground out from under true friendship and treading all true fellow-feeling under foot. Leaving Jean-Jacques Rousseau, a pioneer of this attack, to one side, it is enough to consider what the Scottish Enlightenment writers said on the matter in rebuttal. Sociologist Allan Silver points out that for Adam Smith "instrumental" friendships based on exchange (What have you done for me lately?) were actually "more pervasive before commercial society instituted the distinction between markets and personal relations." Further, in pre-capitalist societies, as understood by the Scottish thinkers, "the space between friend and enemy was not occupied, as in commercial society, with mere acquaintances or neutral strangers, but charged with uncertain and menacing possibilities."

Thus the "Scots understand commercial society as limiting instrumental exchange to the newly distinct domain of the market. . . . Before commercial society, the purpose of friendship, as the Scots see it, was to help friends by defeating enemies. . . ." So it turns out, on the Scottish thinkers' analysis, that we can see "commercial society, far from 'contaminating' personal relations with instrumentalism, as 'purifying' them by clearly distinguishing friendship from interest."[12]

While we are still on the theme of social disruption, we may ask who causes the bulk of it. Political scientists Youssef Cohen, Brian R. Brown, and A. F. K. Organski have pointed out that a good many Third World conflicts "are defensive in nature: they are all brought about by the aggressive expansionism of the state," especially where "states are still involved in the primitive accumulation and centralization of power resources." These writers suggest that "over a relatively long period of time state expansion will generate violent conflict" and thus "it is the progression toward greater order itself that produces much of the relatively greater violence we find in new states."

They conclude that "the evidence strongly suggests that the rate of economic development is related to both the rate of state expansion and collective violence in a way that runs contrary to the way postulated by the dominant view on such matters." Further, "*state expansion seems to produce much more violence than economic growth.* . . . Rather than state expansion being an antidote for the violence produced by economic modernization, our rather limited evidence shows that it is economic modernization which is the antidote to the violence produced by state expansion."[13]

State-building may itself be the fundamental error and so-called "failed states" may well have earned their plight. Of course an array of stupid Cold War tricks played by the great powers in those countries can answer for part of the outcome as well. But this consideration leaves us yet within the realm of state action.

To put matters another way, markets work well at what they are supposed to do; governments work badly at what they are *supposed* to do. Governments do, however, work well at other things: creating violence, disorder, and disrupting orderly social life. Since they do so while imposing something they *call* "order"—by threats, intimidation, and violence—most people are content to imagine that governments are the *source* of order.

Inflation

Many writers see inflation, especially where it refers to any set of rising prices, as another problem inherent in the market economy. The state must there-

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fore be ever watchful and ready to resort to various stern measures to "fight inflation." Some critics—for example, the conservative historian John Lukacs—like to talk vaguely of general social inflation: of values, grades, esthetics, and everything. And while he does not lay these ills directly at the feet of the market economy, others do. For many critics, market relations as such are supposed to render everyone radically unstable, rationally self-centered, and prone to go deeply into debt so as to have the whole panoply of consumer goods sooner.

But leaving to one side the cultural question of the inflation of the American ego by Emerson, Whitman, and others, price inflation would seem the primary culprit and it comes from the state. If individual rates of time preference are lowered by easy credit, leading to the consequences of which many writers complain, we must inquire into the origins of the easy credit. Obviously, I take it as having been thoroughly shown by Ludwig von Mises and Rothbard, among others, that inflation *is* the expansion of the supply of money through state-controlled central banks, which, if taken far enough, is the cause of economic depressions.[14]

The cultural history of the late nineteenth and early twentieth centuries is badly in need of rewriting by a historian who can analytically separate out new methods of mass marketing (for example, by Sears and Roebuck), installment buying, "Fordism," and the like, from monetary expansion by the Federal Reserve. Once this is done, we may expect to learn that "inflationary" excesses in culture, consumption, education, and so on arose crucially from expectations grounded in easy money. As noted, easy money leads us straight to the state, the central bank, and their social allies in business and academe who believed that an expanding money supply was the key to prosperity. The unhampered market, once more, may plead innocent.

Market Failure

Dear old "market failure" must necessarily be mentioned here. This notion is basically the obverse of the public-goods problem. Suffice it to say that in the view of some observer, "the market" has failed to do X, or provide much-needed service Z.

Part of the problem stems from the tendency to reify the market and then fault this monolithic mechanism or super-mind, or whatever it is supposed to be. But the market is not a thing or a person, but is instead a complex and extensive network of bilateral exchanges, which for convenience we *call* the "market."[15] Another variant is to complain that exchanges are being blocked by excessive transaction costs or the like, when on the face of it, a particular "market" hasn't come into being simply because, as things stand, no one wants to exchange the things some observer would like to see exchanged.[16] I don't know who is supposed to keep track of missing markets that *should* exist, unless of course it is the state.

But we must leave this topic for now, since it is large enough to justify treatment elsewhere.

The alleged "atomization of society" brings us to the grave problem of "social action." It is interesting that whenever successful social action takes place, as it does all the time, governments and their apologists immediately denounce it as a dreadful evil, because the people cooperating do not do what these observers would like them to do. Actually occurring social action always turns out to be the *wrong kind*, and is reinterpreted as a social problem.

One thinks of the gathering attack on societies in which kinship relations help structure business relations and markets—as in East Asia, for example. This, apparently, is the most wicked "crony capitalism," which, lacking transparency and the like, must be corrected by whatever superpower happens to be in the neighborhood. But from a free-market standpoint, what is actually wrong with doing business with your cousin, if the state as such is not in the picture?

Stamping out "ethnic" allegiances in trade in the name of market freedom, "transparency," and fairness might sound good to some people, but who exactly would do the stamping? Obviously, it would have to be the state, which is the indispensable culprit in crony capitalism to start with. (This is a key in Russia and China, where it is often the former communist bureaucrats who are today the state-connected crony capitalists.)

During the Vietnam War, well-placed American social scientists studied the supposed failure of social action in South Vietnam. What this seems to have meant is simply that such social cooperation as existed failed to generate much support for the South Vietnamese state

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sponsored by the United States. Given the alleged absence of a properly functioning social structure, one theorist suggested that the South Vietnamese state *substitute itself* for the missing intermediate structures.[17] We cannot resolve here the obvious problem that if the *state* provides the structures, they will no longer be very intermediate.

It is probably not market relations that have leached away people's personal autonomy, thereby reducing their ability to cooperate and undertake social action. Once again, I would suggest looking in the direction of the state.

Tying of Services and Products

Another complaint is that businesses attempt to "tie" goods and services to one another, rendering the poor consumer dependent on one product line. They may well *try*, but other actors in the market and consumers themselves will find ways around this practice.

It is otherwise with the state. As Sheldon Richman has mentioned to me, states "tie" their "products" and "services" all the time. As a precondition of driving on government roads, you get to patronize the government-sponsored insurance cartel. In some states you get to have your car checked by a government-sponsored mechanic. Go to a government airport and you get a taste of the government's idea of providing security.

And your Social Security number, which Congress swore would never become a national ID, is fast coming to resemble a Soviet-style internal passport.

Even on the most pessimistic reading of this issue, the market remains well ahead of the state.

Now we come to the claim that business corrupts politics. Well, yes and no. Politics does not seem to require much corrupting.

Naturally, there are plenty of actual businessmen who are happy to enlist the state to restrain trade for them, grant them subsidies and bounties, and the rest. They try to *use* the state for their economic advantage. This is the "instrumentalist" view of the state, which holds true across a wide range of activities and which is, despite what some writers think, entirely compatible with a great deal of state "autonomy." After all, if the state did not have independent *power*, it wouldn't be much of an aid to these interest groups, would it?

There is indeed plenty of business-government collaboration around, enough to justify calling it by its own name: corporatism.[18] Since such practices are the antithesis of laissez-faire liberalism, it is hard to see how the free market can rightly get the blame for them. We are back in the ballpark of the state again, this time with some of its allies.

I have long believed that if a given society had suffered, successively, a drought, a famine, and a flood, followed by a popular revolt set off by grinding taxation and, finally, a foreign invasion, the typical historian would lay primary blame for the unhappiness of the people on the failure of the market economy. We have just seen this kind of judgment made in relation to the disaster in New Orleans.

Even if we were somehow to blame the sinking of New Orleans on politicians who *talk* a lot about free markets, this has nothing to do with any real chain of causation that would reach back to the free market. The *talkers* currently in office have famously spent hundreds of billions of dollars on misbegotten war in Iraq, which suggests that their *talk* about *frugality*, free markets, and the rest is so much eyewash. There is no disembodied "free-market ideology" stalking the country and forcing the poor government to leave levees in disrepair or unimproved.

Talk is cheap, not frugal.

After all, despite the alleged outbreak of frugality, billions upon billions of dollars still flow into the federal treasury and bureaucrats still manage to spend them. Neither the people nor the free market—conspicuous by its absence–should answer for bad decisions made by officials allocating money taken from the toiling masses. Probably if you have a levee, you ought to maintain it. This is entirely separate from the question of whether government should have been in the levee-building business in the first place, or whether people should live in flood zones. Tackling these questions would involve us in an historical regression into the remote origins of a situation significantly shaped by government, a situation fraught with peril if the government should ever let its own creations slide.

The buck still stops with the federal government because it *took* the bucks, some of which could have fixed its levees, and then did not do so. Leaving aside the

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ethics of how governments get their money, the United States had plenty of it, and chose to squander much of it on a night out in the Middle East. The left is right to point this much out.

But the left will not follow us further along our path of analysis. This particular mixture of state activity and inactivity—Iraq versus New Orleans—goes to such questions as whether governments are very good at managing anything and whether states can even calculate rationally. Our best evidence says, no. As Rothbard puts it, "[T]he costs of government are bound to be much higher than those of the free market. . . . [T]he State cannot calculate well and therefore cannot gauge its costs accurately."[19]

So, no, the free market did not sink New Orleans, nor did its shambling cousin, the disembodied and *selective* free-market *talk* found in and around the Republican Party.

A Parthian Shot

The last topic broached reminds us that the Republican Party habitually proclaims its fervent wish to put government "on a businesslike basis." Democrats usually favor putting business on a government-like basis. The difference between the two programs is this: the second is possible and it could go forward, up to the point that social cooperation and markets collapse; the former is literally impossible.

Government cannot be put on a businesslike basis because it lacks the profit-and-loss test available to businesses on the market. Thus it doesn't know when to stop doing something, short of a disastrous setback, cannot calculate its costs, and so on. But enough about government; I think we can agree that for the topics just canvassed at least, the market is not guilty and the state is about to enter the witness box.

1. Murray N. Rothbard, *Man, Economy and State*, vol. 2 (Los Angeles: Nash Publishing, 1970 [1962]), p. 759.

2. Tom Burns, "Sovereignty, Interests and Bureaucracy in the Modern State," *British Journal of Sociology*, December 1980, pp. 494–95.

3. Jörg Guido Hülsmann, "Political Unification: A Generalized Progression Theorem," *Journal of Libertarian Studies*, Summer 1997, pp. 81–96.

4. Bruce Porter, *War and the Rise of the State* (New York: Free Press, 1994), William Hardy McNeill, *The Pursuit of Power* (Chicago: University of Chicago Press, 1982), and Charles Tilly, "Warmaking and Statemaking as Organized Crime," in Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol, eds., *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985), pp. 169–91.

5. Joseph Schumpeter, *Capitalism, Socialism, and Democracy* (New York: Harper & Row, 1950), p. 144.

6. On war and time preference, see Hans-Hermann Hoppe, "Time Preference, Government, and the Process of De-Civilization," in John V. Denson, ed., *The Costs of War* (Auburn, Ala.: Ludwig von Mises Institute, 1999), pp. 455–508.

7. Siân Miles, ed., *Simone Weil: An Anthology* (New York: Weidenfeld & Nicolson, 1986), pp. 174–75, 181.

8. Rothbard, chapter 10, "Monopoly and Competition," pp. 560–660.

9. Ibid., p. 591, Rothbard's wording, not Coke's.

10. Ibid., p. 789.

11. Paul Baran and Paul Sweezy, *Monopoly Capital* (New York: Monthly Review Press, 1970).

12. Allan Silver, "Friendship in Commercial Society: Eighteenth-Century Social Theory and Modern Sociology," *American Journal of Sociology*, May 1990, pp. 1481–82, 1484, and 1487.

13. Youssef Cohen, Brian R. Brown, and A.F.K. Organski, "The Paradoxical Nature of State Making: The Violent Creation of Order," *American Political Science Review*, December 1981, pp. 904, 907–909 (italics added).

14. Rothbard, pp. 745–47.

15. For all that has been said against nominalism, sometimes we *are* dealing with a name.

16. One could almost call this the Chicago School variant.

17. Charles A. Joiner, "The Ubiquity of the Administrative Role in Counterinsurgency," *Asian Survey*, August 1967, p. 553.

18. See Robert Higgs, *Against Leviathan: Government Power and a Free Society* (San Francisco: Independent Institute, 2005).

19. Such problems are in a way the socialist calculation problem writ small; see Rothbard, pp. 803 and 825–26, where he notes that under socialism "*each* governmental firm introduces its *own* island of chaos into the economy; *there is no need to wait for full socialism for chaos to begin its work*" (p. 826). Obviously, the principle applies in its proper degree to government "firms" or departments under present-day "mixed-economy" corporatism.

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How U.S. Economic Warfare Provoked Japan's Attack on Pearl Harbor

BY ROBERT HIGGS

Ask a typical American how the United States got into World War II, and he will almost certainly tell you that the Japanese attacked Pearl Harbor and the Americans fought back. Ask him why the Japanese attacked Pearl Harbor, and he will probably need some time to gather his thoughts. He might say that the Japanese were aggressive militarists who wanted to take over the world, or at least the Asia-Pacific part of it. Ask him what the United States did to provoke the Japanese, and he will probably say that the Americans did nothing: we were just minding our own business when the crazy Japanese, completely without justification, mounted a sneak attack on us, catching us totally by surprise in Hawaii on December 7, 1941.

The attack on Pearl Harbor, December 7, 1941

You can't blame him much. For more than 60 years such beliefs have constituted the generally accepted view among Americans, the one taught in schools and depicted in movies—what "every schoolboy knows." Unfortunately, this orthodox view is a tissue of misconceptions. Don't bother to ask the typical American what U.S. economic warfare had to do with provoking the Japanese to mount their attack, because he won't know. Indeed, he will have no idea what you are talking about.

In the late nineteenth century, Japan's economy began to grow and to industrialize rapidly. Because Japan has few natural resources, many of the burgeoning industries had to rely on imported raw materials, such as coal, iron ore or steel scrap, tin, copper, bauxite, rubber, and petroleum. Without access to such imports, many of which came from the United States or from European colonies in southeast Asia, Japan's industrial economy would have ground to a halt. By engaging in international trade, however, the Japanese had built a moderately advanced industrial economy by 1941.

At the same time, they also built a military-industrial complex to support an increasingly powerful army and navy. These armed forces allowed Japan to project its power into various places in the Pacific and east Asia, including Korea and northern China, much as the United States used its growing industrial might to equip armed forces that projected U.S. power into the Caribbean and Latin America, and even as far away as the Philippine Islands.

When Franklin D. Roosevelt became president in 1933, the U.S. government fell under the control of a man who disliked the Japanese and harbored a romantic affection for the Chinese because, some writers have speculated, Roosevelt's ancestors had made money in the China trade.[1] Roosevelt also disliked the Germans (and of course Adolf Hitler), and he tended to favor the British in his personal relations and in world affairs. He did not pay much attention to foreign policy, however, until his New Deal began to peter out in 1937. Afterward, he relied heavily on foreign policy to fulfill his political ambitions, including his desire for reelection to an unprecedented third term.

When Germany began to rearm and to seek *Lebensraum* aggressively in the late 1930s, the Roosevelt administration cooperated closely with the British and

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the French in measures to oppose German expansion. After World War II commenced in 1939, this U.S. assistance grew ever greater and included such measures as the so-called destroyer deal and the deceptively named Lend-Lease program. In anticipation of U.S. entry into the war, British and U.S. military staffs secretly formulated plans for joint operations. U.S. forces sought to create a war-justifying incident by cooperating with the British navy in attacks on German U-boats in the north Atlantic, but Hitler refused to take the bait, thus denying Roosevelt the pretext he craved for making the United States a full-fledged, declared belligerent—an end that the great majority of Americans opposed.

In June 1940, Henry L. Stimson, who had been secretary of war under Taft and secretary of state under Hoover, became secretary of war again. Stimson was a lion of the Anglophile, northeastern upper crust and no friend of the Japanese. In support of the so-called Open Door Policy for China, Stimson favored the use of economic sanctions to obstruct Japan's advance in Asia. Treasury Secretary Henry Morgenthau and Interior Secretary Harold Ickes vigorously endorsed this policy. Roosevelt hoped that such sanctions would goad the Japanese into making a rash mistake by launching a war against the United States, which would bring in Germany because Japan and Germany were allied.

Accordingly, the Roosevelt administration, while curtly dismissing Japanese diplomatic overtures to harmonize relations, imposed a series of increasingly stringent economic sanctions on Japan. In 1939 the United States terminated the 1911 commercial treaty with Japan. "On July 2, 1940, Roosevelt signed the Export Control Act, authorizing the President to license or prohibit the export of essential defense materials." Under this authority, "[o]n July 31, exports of aviation motor fuels and lubricants and No. 1 heavy melting iron and steel scrap were restricted." Next, in a move aimed at Japan, Roosevelt slapped an embargo, effective October 16, "on all exports of scrap iron and steel to destinations other than Britain and the nations of the Western Hemisphere." Finally, on July 26, 1941, Roosevelt "froze Japanese assets in the United States, thus bringing commercial relations between the nations to an effective end. One week later Roosevelt embargoed the export of such grades of oil as still were in commercial flow to Japan."[2] The British and the Dutch followed suit, embargoing exports to Japan from their colonies in southeast Asia.

An Untenable Position

Roosevelt and his subordinates knew they were putting Japan in an untenable position and that the Japanese government might well try to escape the stranglehold by going to war. Having broken the Japanese diplomatic code, the Americans knew, among many other things, what Foreign Minister Teijiro Toyoda had communicated to Ambassador Kichisaburo Nomura on July 31: "Commercial and economic relations between Japan and third countries, led by England and the United States, are gradually becoming so horribly strained that we cannot endure it much longer. Consequently, our Empire, to save its very life, must take measures to secure the raw materials of the South Seas."[3]

Because American cryptographers had also broken the Japanese naval code, the leaders in Washington knew as well that Japan's "measures" would include an attack on Pearl Harbor.[4] Yet they withheld this critical information from the commanders in Hawaii, who might have headed off the attack or prepared themselves to defend against it. That Roosevelt and his chieftains did not ring the tocsin makes perfect sense: after all, the impending attack constituted precisely what they had been seeking for a long time. As Stimson confided to his diary after a meeting of the war cabinet on November 25, "The question was how we should maneuver them [the Japanese] into firing the first shot without allowing too much danger to ourselves."[5] After the attack, Stimson confessed that "my first feeling was of relief . . . that a crisis had come in a way which would unite all our people."[6]

1. Harry Elmer Barnes, "Summary and Conclusions," in *Perpetual War for Perpetual Peace: A Critical Examination of the Foreign Policy of Franklin Delano Roosevelt and Its Aftermath* (Caldwell, Id.: Caxton Printers, 1953), pp. 682–83.

2. All quotations in this paragraph from George Morgenstern, "The Actual Road to Pearl Harbor," in *Perpetual War for Perpetual Peace*, pp. 322–23, 327–28.

3. Quoted ibid., p. 329.

4. Robert B. Stinnett, *Day of Deceit: The Truth about FDR and Pearl Harbor* (New York: Free Press, 2000).

5. Stimson quoted in Morgenstern, p. 343.

6. Stimson quoted ibid., p. 384.

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The Early History of FEE

BY HENRY HAZLITT

I've been invited to share some recollections about the early days of the Foundation for Economic Education. It must have been sometime in 1944 or 1945 that a handsome man dropped in to see me at the *New York Times,* where I was then writing the economic editorials, and introduced himself as Leonard Read, general manager of the Los Angeles Chamber of Commerce.

The free-enterprise philosophy had already become almost a religion with him. He told me he was looking for a wider audience to which to explain that philosophy, and was thinking of setting up a libertarian foundation of his own.

Leonard E. Read (1898–1983)

FEE Archives

In 1946 Leonard had raised the money, set up the Foundation for Economic Education here at Irvington, and invited me to become one of his original trustees and officers.

It is astonishing how soon Leonard's action began to produce important results. Friedrich Hayek, in London, impressed by Read's initiative, raised the money the next year, 1947, to call a conference at Vevey, Switzerland, of 43 libertarian writers, mainly economists, from half a dozen nations. The group of ten of us from the United States included such figures as Ludwig von Mises, Milton Friedman, George Stigler—and Leonard Read. That was the beginning of the still flourishing and immensely influential Mont Pelerin Society, now with several hundred members from dozens of countries.

Another effect of Leonard's initiative soon followed. Other libertarian foundations were set up in emulation. "Baldy" Harper, who had been working as an economist for FEE from its first year, left in 1958 and started his Institute for Humane Studies in 1963 in California. Soon Antony Fisher set up like organizations in England, Canada, and eventually here. I recently learned from Antony that he is now watching over eighteen institutions in eleven countries. Manuel Ayau in Guatemala established his libertarian Universidad Francisco Marroquín. Groups in other Latin American countries have set up their own equivalents of FEE. It would take too long to name all the present institutions here and abroad, even if I knew of them all, that owe their origin directly to Leonard Read's example.

Let me return to the early days of the Foundation. The original officers were David M. Goodrich, chairman of the Board (he was then also chairman of the board of the B. F. Goodrich Company); Leonard Read, president; myself, vice-president; Fred R. Fairchild, professor of economics at Yale University, secretary; and Claude Robinson, president of the Opinion Research Institute, treasurer. There were sixteen trustees. They included H. W. Luhnow, president of William Volker & Company; A. C. Mattei, president of Honolulu Oil Corporation; William A. Paton of the University of Michigan; Charles White, president of the Republic Steel Corporation; Leo Wolman, professor of economics at Columbia; Donaldson Brown, former vice-president of General Motors; Jasper

Henry Hazlitt had a long and distinguished career as economist, journalist, author, editor, and literary critic. This article, first published in the March 1984 issue of The Freeman, *is excerpted from his remarks at the Leonard E. Read Memorial Conference on Freedom, November 1983.*

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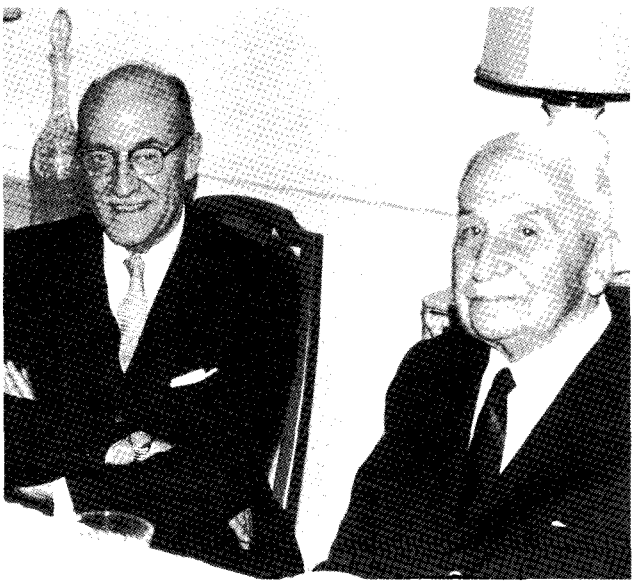
Crane, former vice-president of Du Pont; B. E. Hutchinson, chairman of the finance committee of Chrysler Corporation; Bill Matthews, publisher of the *Arizona Star;* W. C. Mullendore, president of the Southern California Edison Company; and the officers of FEE.

You can see from this list what Leonard Read's persuasive powers must have been.

FEE opened its doors on March 16, 1946. Most of the spring and summer was spent in the library, as renovation continued on the main building. The staff, as of September 1946, consisted of Leonard Read as President, Herbert Cornuelle as assistant to the President, W. M. Curtiss as Executive Secretary, Baldy Harper as Economist, Orval Watts as Editorial Director, and A. D. Williams, Jr. as director of public relations.

Leonard's first move was to publish an outline of the aims of the Foundation and its proposed activities. He listed no fewer than fourteen of these that would be "among those to be considered for program inclusion" as the resources of the Foundation would permit. I condense them here: (1) encouragement, including financial assistance, to scholars, (2) special studies of current economic or political issues, (3) pamphlets applicable to "hundreds of economic problems," (4) leaflets for mass distribution, (5) a journal (this was realized in mid-1954 when FEE took over *The Freeman),* (6) books: the abridgment, publication, and distribution of classical works such as, for instance, *The Wealth of Nations* and *The Federalist Papers,* (7) the promotion and publication of satisfactory textbooks, (8) a "pamphlet-of-the-month club," (9) a radio program, nationwide, (10) organize advisory and study groups in every state and in every community in America—*not* political action groups, (11) analysis of collectivistic trends so that new interventionist proposals can be examined and refuted before they have been adopted, (12) a lecture institute, (13) arranging for graduate students in economics and potential instructors to accept short-term positions in industry to acquaint them with actual production problems. And finally, (14) a study of the methods of financing and integrating all these activities.



Henry Hazlitt and Ludwig von Mises

FEE Archives

And then in an amazingly short time a stream of publications began to pour forth. There were more than a hundred in the first few years. Some of these were one-page leaflets, some small folders, some moderate-length pamphlets, and some were in effect short books. I must confine myself to mentioning only a few of these, in their order of publication. The earliest I find is *Profits and the Ability to Pay Wages,* by Professor Fred Fairchild of Yale. This came out in August, 1946; it ran to 64 pages. A month later came a 22-page pamphlet called *Roofs or Ceilings?,* an attack on rent control, sent in by two young fellows from the University of Chicago, Milton Friedman and George J. Stigler, both destined to become future recipients of the Nobel prize in economics. FEE distributed 36,000 of these, plus a special condensed version of 500,000 copies for the National Association of Real Estate Boards.

Next, still in 1946, came a 74-page reprint of Andrew Dickson White's famous monograph, originally written in 1876, on *Fiat Money Inflation in France.* FEE eventually distributed 52,000 copies of this. In January, 1947, FEE published an 88-page study called *Wages and Prices* by Professor Jules Bachman of New York University.

Planned Chaos

Next, in 1947, came *Planned Chaos,* a 90-page pamphlet by Ludwig von Mises. Lu had been put on the payroll by Leonard from the first year of the Foundation. Next in 1947 FEE began to publish Henry Grady Weaver's *Mainspring of Human Progress,* and to date has distributed 670,000 copies of it. The edition I have runs to 287 pages.

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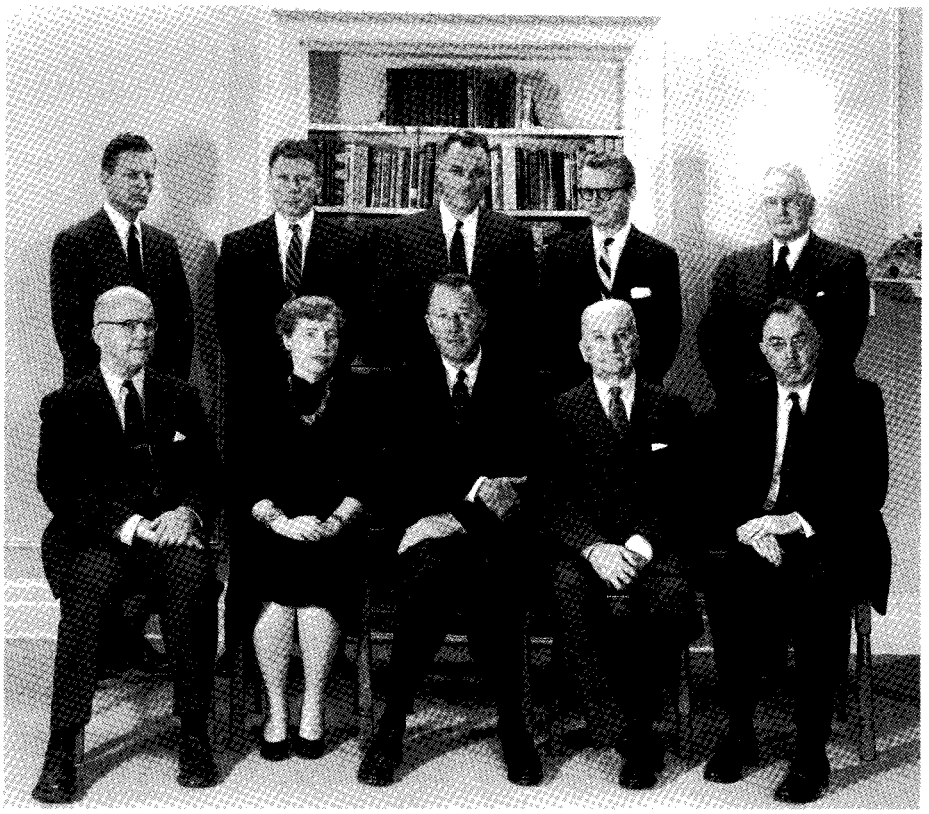

FEE Senior Staff in the mid-1950s: Front: W. M. Curtiss, Bettina Bien (Greaves), Leonard Read, Ludwig von Mises, F.A. Harper; back: Paul Poirot, Edmund Opitz, Ivan Bierly, Charles Hull Wolfe, Thomas Shelly

FEE Archives

Late in 1947 a short book of mine—95 pages—was published called *Will Dollars Save the World?* in paperback and hardcover. Appleton-Century printed the hardback edition at $1.50.

I'd like to say a few words about it, because it illustrates a disheartening consequence—or lack of consequence. By pre-arrangement with Appleton, Leonard ran off a first printing in paperback of 80,000 copies. (This was over my protest, because I thought he would get stuck with them. But he sold out practically the whole edition.) Then in January, 1948, the *Reader's Digest* reprinted a 6,500-word condensation of the book not only in its American but in all twenty of its foreign editions, a total circulation then of about 13 million copies. One immediate consequence is that FEE's own sales of the paperback came to a halt. Another was that I was asked to testify first before a Senate and then before the corresponding House committee on the then-pending foreign-aid bill. But with all this undreamed-of publicity, I haven't a shred of hard evidence that my book or the *Reader's Digest* condensation of it saved the American taxpayer one slim dime in our foreign-aid outlays.

For that matter, I see no evidence that the Friedman-Stigler pamphlet did anything to slow down rent control. Nor can I think of any other of FEE's publications that had any direct effect on actual legislation.

On the surface, as I have said, this seems dreadfully disheartening. But it must be acknowledged that the American ideological situation is much better than if FEE had never come into being. Our institution has inspired the formation of dozens of others. Increasing numbers of people now know what is wrong. True, we have inflation everywhere, but few countries now try to combat it with general price controls. FEE has provided precisely what its title promised—economic education. Even Adam Smith's *Wealth of Nations,* let us remember, did not begin to change actual legislation until many years after its original appearance.

Let me resume our history. In 1948 FEE published F. A. Harper's 71-page pamphlet on *High Prices,* and in 1949 Harper's 159-page book *Liberty: A Path to its Recovery.* Frédéric Bastiat's 75-page pamphlet, *The Law,* was translated by Dean Russell and published by FEE in 1950. So far, the Foundation has distributed 344,000 copies.

I come to one final item. It was in December, 1958, that Leonard first published his essay entitled "I, Pencil." The theme of that article, as most of you will remember, is that "no single person on the face of this earth knows how to make a pencil." It is a little classic—the essay of Leonard's that is certain to be long, long remembered. . . .

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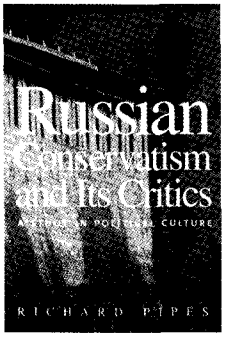
Book Reviews

Russian Conservatism and Its Critics

by Richard Pipes
Yale University Press • 2006 • 216 pages • $30.00

Reviewed by Richard M. Ebeling



Why do some nations seem more open to the ideas of liberty, while others appear resistant to them? Friends of freedom often work from the axiom that liberty is something all men desire and want. Yet there are parts of the world in which large portions of the population seem to resist the trend toward liberal democracy and free markets. Both intellectuals and "ordinary" people in those societies often say they reject "Western" notions of freedom and individualism.

This question touches on many of the most important issues of the contemporary world. One example of a country that seems to be reversing many of its earlier steps toward the rule of law, civil liberties, and market freedom is Russia. I was in Moscow in August 1991, when a group of hard-line Communist Party members attempted a coup to prevent the breakup of the Soviet Union and to reassert centralized Party control. After three days, the coup failed. The next day, in a large square behind what was then the Russian Parliament building, thousands of Muscovites attended a rally to celebrate the survival of their fledgling democracy. At one point there arose from the ocean of people a chant, which they shouted in unison: *Swaboda! Swaboda! Swaboda!*—Freedom! Freedom! Freedom!

After nearly 75 years of communist tyranny, those Russians were declaring their hope and desire for the chance to be like us in the West—what they called a "normal society." Yet 15 years later the hope has faded a great deal. The government of Vladimir Putin has reasserted central control over the far-flung regions and districts of the country. Radio and television news is dominated by the government, as are many newspapers. Many economic reforms have been reversed, with government ownership or control of the economy being reestablished. The new class of wealthy Russian businessmen, sometimes referred to as the "oligarchs," has been thoroughly intimidated by the government, with few of them willing to risk their property and position by challenging Putin's near monopoly over political power. And there is a longing and nostalgia among many in the country for the reestablishment of Russia as a great power that would be feared and followed in the arena of international politics.

Part of the reason why there has been acceptance of these trends by so many in Russia has to do with the culture and the mentality that has evolved and shaped the Russian outlook on life, society, and the State over several centuries. Richard Pipes's recent book, *Russian Conservatism and Its Critics*, attempts to explain how this has come about.

In the beginning there were accidents of history. The Mongols invaded and conquered what is now European Russia. They appointed the ruthless rulers of the Grand Duchy of Moscovy as their enforcer of taxes and control. When the Mongols withdrew 400 years later, Moscow asserted itself by expanding and annexing regions that were potentially more open to liberal and commercial values. As the conquest advanced, the rulers in Moscow threatened the position and wealth of the Orthodox Russian Church and the landed aristocracy. To hold on to what they had, they conceded total power to the expanding government in Moscow. They gave away all their potential "rights" to maintain their political privileges under the absolute autocratic rule of the Russian monarch, the tsar. This meant that unlike in the West, there were no countervailing sources of power to check the authority of the king.

There was a consensus that in a country as large as Russia, with an ethnically diverse population, and with no "natural borders" to block potential invaders, strong, centralized power was necessary to hold the state together. The three elements of legitimacy for the Russian monarchy became autocracy, religious orthodoxy, and a growing nationalism that emphasized the unique and special character of the Russian people, making them distinct from other peoples in the West.

As much as both Russian liberals and advocates of absolute monarchy may have admired and valued what

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they saw and learned from France and England in the eighteenth and nineteenth centuries, they all were suspicious of or hesitant about a liberal political system in Russia. Social unrest and political chaos could be prevented only by strict obedience and loyalty to the all-powerful tsar.

Russian religious orthodoxy emphasized that only the Russian Church had remained pure and devout in the face of the decadence and wayward spirit of the Western Christian faiths. Russian Orthodoxy was the true faith, ordained by God to bring salvation to the world. Western ideas could only poison the Russian soul and threaten Russia's religious mission in God's plan.

Even in the last decades of the nineteenth century, when Russian liberals attempted to influence political currents, they could not let go of the idea of autocracy. The most laissez-faire of the Russian liberals, Boris Chicherin (1828–1903), could not endorse Western-style representative government. He insisted that to do so "would mean renouncing one's whole past, rejecting the obvious and universal fact of our history that demonstrates clearer than the day that autocracy can lead the nation with giant steps toward citizenship and enlightenment. . . . In a word, under present conditions, popular representation will bring nothing but chaos."

Peter A. Stolypin (1862–1911), Russia's last important pro-market reformer before World War I, declared, "Supreme authority is the sustaining idea of the Russian state, it embodies its strength and unity, and if Russia is to be, then it will be only by the effort of her sons to defend, to protect this authority, which has forged Russia and keeps her from disintegrating." As for Western political ideals, he added, "One must not attach to our Russian stem some alien, foreign flower."

Even the peasantry endorsed the idea of absolute monarchy. In the late nineteenth century, Pipes points out, "the peasants regarded the tsar as the proprietor of Russia and expected to receive from him the land allotments they so desperately needed. Peasant rebellions in Russia were invariably directed not against the tsar but carried out in the name of the tsar against what the rebels perceived as selfish nobles and usurpers of the tsar's authority."

Russia's status as a great power that stretched from the Baltic Sea to the Pacific Ocean was attributed by the Russian people to the unquestioned power of the monarchy. Centralized power not only kept Russia together, it also made Russia a force among the powers of the world—something Russians could take pride in regardless of how lowly their rank might be.

Autocratic government, Pipes explains, prevented the emergence of an independent middle class. Private property rights never took hold because in principle all land and the objects on it were the possessions of the tsars. There were none of the intermediary institutions of civil society that had nurtured the growth of liberty in the West.

These are the cultural and psychological legacies left to the Russian people by centuries of autocratic rule, many of which were reinforced by three quarters of a century of communist dictatorship. Pipes's book may help us to understand why Russia's path to liberty seems so slow and tortuous.

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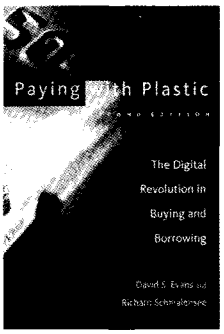
Paying with Plastic: The Digital Revolution in Buying and Borrowing, 2nd edition

by David S. Evans and Richard Schmalensee
MIT Press • 2005 • 367 pages • $62.00 hardcover; $24.95 paperback

Reviewed by J. H. Huebert



The market has an amazing ability to induce voluntary cooperation among millions of people around the globe to provide goods and services we tend to take for granted. Leonard Read showed this by telling the story of a simple lead pencil. In *Paying with Plastic*, the authors relate the similarly impressive story of the credit card.

Today, of course, you can use your credit card almost anywhere to buy anything. But not long ago, credit cards were unheard of. If you wanted to borrow money, you went to the bank and took out a loan. Or you might have had a charge account at a store you frequented—but your bill had to be paid off each month. Early charge cards from Diner's Club and American Express, which

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arrived in the 1950s, worked the same way, requiring full payment each month, and were narrowly targeted at business travelers.

Credit cards as we know them didn't really exist until the late 1960s, when banks across the country joined together to form the organizations we now know as MasterCard and Visa. Few people who use credit cards today know the massive amount of voluntary cooperation that was required to bring them into existence and make our everyday card purchases possible.

Consider, for example, that MasterCard and Visa are joint ventures, owned by all the banks that issue those cards or offer accounts to merchants who accept them. As the authors note, the member banks remain competitors in all facets of their business, *even the credit-card issuing business*, but nonetheless cooperate at the card-system level to set standards and allow consumers to use the same cards across the country, and around the world, regardless of whom they bank with.

This should give pause to statists who insist we need antitrust laws to prevent businesses from collaborating with each other. Here we have banks "conspiring" in a way that unquestionably benefits consumers by maximizing both convenience and competition.

Inventing the cards was one thing—but it's another free-market miracle that anyone uses them. After all, when the Visa card and MasterCard were created, no consumers had one, and no businesses accepted them. The banks had to figure out how to make consumers want a credit card no one accepted and how to make businesses accept credit cards no one carried! *Paying with Plastic* explains how they did it.

And you may have noticed that when a merchant swipes your credit card, he does so through the same terminal, regardless of what type of card it is. How can one little machine not only handle different card brands, but also move money between the various banks involved, all in about two seconds? Again, the book provides an easily understood explanation. And although the authors don't consider this implication, their discussion of this issue made me think about how the use of free-market money (say, gold) would be easier than ever given modern technology.

If the book's story has a villain, it is government. Many states, for example, have obstructed the growth of credit cards through usury laws—that is, they have imposed price controls. (Banks escaped this problem by moving their offices to friendlier states, such as South Dakota.) And, of course, federal antitrust authorities are always looking for new reasons to harass businesses that have done nothing more than voluntarily cooperate with consumers and each other. The authors do a fine job of explaining the economics of those and other government interventions and how they harm consumers.

Unfortunately, the authors fail to note that banks themselves are not without fault—they benefit from government intervention that allows them to inflate the money supply and effectively steal from all of us. And the book's brief history of money and banking also treats the abandonment of the gold standard too lightly.

Despite these shortcomings, the book focuses on those aspects of the credit-card business produced by peaceful cooperation. It shows how the market, not government, coordinates human action on a grand scale to advance human welfare.

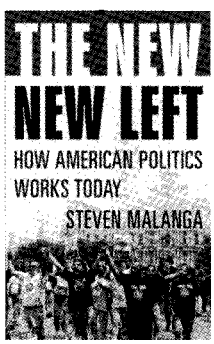
Accordingly, I recommend *Paying with Plastic* not only to those who want to know more about credit cards—and given their ubiquitous role in our lives, you *should* learn about them—but also to anyone seeking a detailed example of the great things even a hampered market can achieve.

J. H. Huebert (jhhuebert@globalweyermedia.com) is an attorney and a former FEE intern.

The New New Left: How American Politics Works Today

by Steven Malanga
Ivan R. Dee • 2005 • 147 pages • $22.50

Reviewed by George C. Leef



Murray Rothbard liked to argue that our understanding of politics would be improved if we would categorize people as either tax *payers* or tax *consumers*. The latter always desire political action to make their positions more secure and lucrative. Indeed, the increasing politicization of the United States has proceeded hand in hand with the rising number of

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tax consumers. Tax payers, alas, may fail to see that opposition to government expansion is in their interest. Many of them are in the thrall of statist myths and don't understand that their pockets are being picked. Some even applaud.

To all members of the tax-*paying* class, I recommend Steven Malanga's book *The New New Left*. Malanga, a New York-based journalist affiliated with the Manhattan Institute, has dug deep into the dung heap of modern politics to show how various interest groups succeed in getting what they want at the expense of others. Malanga's exposé is certain to provoke screams of protest from the tax consumers because he's so good at demolishing their intellectual pretensions.

Government-employee unions are one of the book's main targets. Malanga writes, "Today, public unions don't merely use their power to win contract concessions for their members. They help elect sympathetic legislators and defeat proponents of smaller government; they lobby for higher taxes, especially on the rich and on businesses; and they oppose legislative efforts, such as privatization initiatives, aimed at making government smaller and more efficient." That's true not only in union-dominated cities like New York, but also in many others. A lamprey attaching itself to a fish is the image that comes to mind.

Those unions have formed an alliance with leftist politicians in which the politicians can count on union support (money and manpower) and in return they promote the unions' desire for expanded government. A prime example Malanga shows is the health-care industry, where growing governmental involvement has been a gold mine for union treasuries.

Malanga also takes on the numerous activist organizations on the new new left (NNL). One of the most virulent is ACORN (Association for Community Reform Now), which pushes relentlessly for socialistic nostrums such as "living wage" laws. Those laws mandate that businesses must either pay their workers an hourly wage that's supposed to be the least someone could live on, or else face punitive taxes. It's just a super-minimum wage. ACORN and its backers (including the Ford Foundation) try to deny that "living wage" laws have any disemployment effects, but it's hard to suppress the truth. Malanga notes that after Detroit adopted its ordinance, the Salvation Army had to lay off some of its workers because it couldn't afford to keep them all on the payroll. In response, ACORN accused the Salvation Army of "propagating a Big Lie."

Undoubtedly, the Number One Enemy of the NNL is Wal-Mart. The company resists unionization with all legal means. It even chose to shut down a store in Canada, where a union had been certified, rather than bow to collective bargaining. For its stance, the firm receives a steady torrent of invective from Big Labor and its activist allies. They rant, for example, about the low percentage of Wal-Mart employees (compared with other large firms) who have health insurance as a part of their compensation package. Malanga points out an inconvenient fact for the crusaders: many Wal-Mart workers have health-insurance coverage elsewhere, through a pension plan or other family members. No one who finds the compensation at Wal-Mart inadequate has to work there, but many people obviously think it's their best option. Only in a hyper-politicized world would anyone regard the NNL activists who seek to meddle with mutually beneficial exchange as heroes.

In another essay, Malanga takes aim at the faddish notions of Professor Richard Florida. Florida has become an intellectual guru to many for his theories on how to make cities vibrant, growing places. His idea is that if cities attract "creative people," they will thrive. So what flowers will lure these wonderful bees? Florida says that the key is for a city to have the amenities that such people supposedly want for their upscale lifestyle: fine arts, recreation, green spaces, and so on. Therefore, cities should throw plenty of money into performing-arts centers, bicycle paths, parks, and more. Malanga douses Florida's dreamy visions in cold water by demonstrating that those amenities are neither necessary nor sufficient for a vibrant, growing city. It's just another excuse for political elites to spend taxpayer money.

This book is a timely attack on some of America's most destructive political phenomena.

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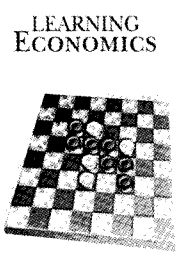
Learning Economics

by Arnold Kling
Xlibris Corp. • 2004 • 376 pages • $32.99 hardcover; $22.99 paperback

Reviewed by Donald J. Boudreaux



Arnold Kling, Ph.D

Because the marginal social value of eloquent explanations of basic economics exceeds the marginal social cost of supplying these explanations, efficiency requires that more such explanations be produced.

Got that?

The jargon-laden opening sentence of this review is typical of much too much economic writing. Economists have many important and interesting things to say about the world, but it's the rare economist who is both able and willing to share economic insights with non-economists. It's the even rarer economist who does so from a market perspective.

Boasting a Ph.D. in economics from M.I.T.—he was a classmate of Paul Krugman—Arnold Kling is as well-credentialed and technically skilled as any economist. He has a knack for using metaphors and analogies effectively; his sentence construction is clear; he assiduously avoids jargon; and he's interested in relevant topics.

Learning Economics is a collection of 57 essays—each about the length of an op-ed—on public-policy topics ranging from health care to education to stock prices. The engaged reader will learn, up-close and clearly, just how a master economist uses the economic way of thinking in ways that matter most.

Learning Economics reminds me of *Capitalism and Freedom*. Like Milton Friedman, Kling isn't shy about using basic economics to push market-oriented policy proposals. Most of these proposals will be agreeable to *Freeman* readers. For example:

"One of the silliest government positions ever created was that of 'Chief Trade Negotiator.' There is no need to negotiate—we can do our part for free trade now. The whole concept of trade negotiation is absurd. It is like saying to your spouse, 'I'll change my underwear regularly, but only if you'll agree to brush your teeth.' We should eliminate our harmful trade barriers, not keep them in place just to have 'negotiating leverage.'"

Some of Kling's proposals will strike many libertarians as dancing with the devil. For example, he advocates what he calls the "bleeding-heart libertarian approach to income redistribution." The libertarian part is to abolish government schooling, health-care subsidies, Social Security, and income taxation. But this plan also relies crucially on instituting a tax on consumption.

Many libertarians disparage such proposals. "It leaks," as some say, using Leonard Read's famous phrase. And indeed it would leak if it were an answer to the question "What's the best possible way to arrange reality?" But Kling isn't here laying out a picture of his ideal world; rather, he's offering a specific proposal to improve the world.

Such efforts as this are easy and tempting to reject. While I believe that we should never lose sight of the attainable ideal, we should also recognize that moving toward that ideal is most likely to be achieved by a series of small steps rather than one heroic leap. We should understand that even small improvements that fall short of the ideal generally are better than no movement at all. Spelling out the details and benefits of practical policy improvements that might be politically doable is a strength of this book.

Not that I agree with everything Kling writes. His macroeconomics is too Keynesian for my taste. But even his Keynesianism is well-argued and should be understood and engaged by serious thinkers.

On almost all non-macroeconomic issues, however, I find myself in enthusiastic agreement with Kling. Here are two of my favorites.

To explain that lower wages paid to foreign workers—such as Indian software programmers—reflect their correspondingly lower productivity, Kling asks the killer question to those who insist that lower foreign wages will drain America of all jobs: "Why don't firms hire more programmers, since they are getting more in value than what they are paying? If the reason that firms do not increase their hiring is that all of the qualified programmers are already working, then why do the workers not demand higher wages? Until wages come in line with productivity, there are unexploited profit opportunities."

Therefore, the fact that American firms still hire lots

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of American workers means that hiring foreign workers at lower wages generally is no better a deal than hiring American workers at higher wages. In other words, don't hold your breath for the giant sucking sound.

Cutting clean through to the heart of the matter on health insurance, Kling observes, "The fundamental problem is that we believe that health insurance is something that only should be received as a gift—never obtained for oneself. Thus, we immediately assume that when a family does not have health insurance, they are to be pitied for not having received the gift, rather than being blamed for not having taken responsibility."

Learning Economics is intelligently and clearly written. I welcome Arnold Kling to my gallery of champions of economic literacy.

Donald J. Boudreaux (dboudrea@gmu.edu) is chairman of the economics department at George Mason University.

Coming in the June Issue of *The Freeman*

Anthony de Jasay on
Belt and Braces in the Labor Market

Joseph R. Stromberg on
The Antifederalists

Russell Roberts on
The End Run to Freedom

James A. Dorn on
Institutions and Development: The Case of China

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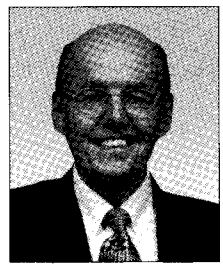

Unions and Abortion Protesters

BY CHARLES W. BAIRD

The National Organization for Women (NOW) and labor unions have a long record of supporting each other in their respective public-policy wars, so one could reasonably expect the AFL-CIO to be on NOW's side in *Scheidler v. NOW*, a long-running case that was finally decided by the U.S. Supreme Court in February. But NOW and the unions were on opposite sides of *Scheidler*.

The reason goes back to a 1973 Supreme Court case, *U.S. v. Enmons*. The question in both cases is: when is it legitimate for a private group to initiate violence and threats of violence in pursuit of its ends? A classical liberal's answer is, of course, never, even if the ends being pursued are themselves legitimate. Alas, in *Enmons* the Court said that when unions initiate violence and threats of violence they are exempt from federal prosecution under the Hobbs Act as long as in doing so they pursue "legitimate" union objectives. The *Scheidler* case was about whether anti-abortion activist groups such as Operation Rescue should enjoy the same exemption to the rule of law given to unions in *Enmons*. The AFL-CIO said yes; NOW said no.

The Hobbs Act amended the federal Anti-Racketeering Act of 1934, which was aimed primarily at organized crime and prohibited violence, threats of violence, and other forms of extortion by individuals and groups against other individuals and groups. As the 1934 Act was working its way through Congress, the American Federation of Labor objected that if applied to labor unions the law would thwart standard union practices in labor disputes. This explicit recognition by the AFL that much of what it did was illicit under ordinary law got Congress to stipulate that unions would be exempt from the Act to the extent that they "lawfully" pursued "legitimate" union objectives.

In *U.S. v. Local 807, International Brotherhood of Teamsters* (1942), the Teamsters asserted that they were lawfully pursuing legitimate union objectives when, using threats and violence, they stopped trucks entering New York City and demanded that the owner-drivers pay tribute to the union equal to a full day's wage before they were allowed to proceed. The Supreme Court agreed with the Teamsters. U.S. Rep. Sam Hobbs and several other members of Congress were outraged by this decision and promulgated the Hobbs Act to reverse the Court. In the words of Rep. John Williams Gwynne, an ally of Hobbs, "I think the intent of the Congress in the 1934 statute was to protect the *lawful* activities of organized labor. The construction put on it by the Supreme Court would authorize *unlawful* acts—certainly never intended by this Congress" (emphasis added). The Hobbs Act became law in 1946.

> The *Enmons* case involved a strike in which individual unionists fired high-powered rifles at three utility company transformers, drained the oil from another transformer, and blew up a company transformer substation, all in pursuit of a higher-pay union contract.

The Act says anyone who "in any way or degree obstructs, delays, or affects commerce or the movement of any article or commodity in commerce, by robbery or extortion or attempts or conspires so to do, or commits or threatens physical violence to any person or property in furtherance of a plan or pur-

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pose to do anything in violation of this section shall be fined not more than $10,000 or imprisoned not more than twenty years, or both." While the Act did not "repeal, modify or affect" any provisions of such pro-union legislation as the National Labor Relations Act (NLRA), it included no explicit exemptions for unions from federal anti-extortion legislation even in pursuit of "legitimate" union objectives.

The *Enmons* case involved a strike in which individual unionists fired high-powered rifles at three utility company transformers, drained the oil from another transformer, and blew up a company transformer substation, all in pursuit of a higher-pay union contract. The Court decided that such violence was exempt from Hobbs Act prosecution because it was in pursuit of a legitimate union objective. The Court asserted that the Act was meant only to bring union violence under the purview of federal anti-extortion legislation if it was in pursuit of illegitimate ends, such as, in *Local 807*, extorting money for work not performed. If the ends were legitimate there could be no extortion. The Court found that since the NLRA empowers unions to strike in pursuit of higher-pay contracts, the use of violence in that pursuit was not extortion.

In dissent Justice William O. Douglas wrote, "[T]he Court today achieves by interpretation what those who were opposed to the Hobbs Act were unable to get Congress to do." In Douglas's view "the regime of violence, whatever its precise objective, is a common device of extortion and is condemned by the Act." Douglas was no classical liberal, but he at least understood that legitimate ends do not justify illegitimate means.

The first Supreme Court decision in the *Scheidler* case was in 1994. In the late 1980s Joseph Scheidler, head of a coalition of anti-abortion groups called the Pro Life Action Network, and others were alleged to have attempted to shut down abortion clinics by picketing, demonstrating, threatening and, in some cases, hostile physical contact with both abortion providers and women seeking their services. These tactics are, of course, often employed by unions during strikes and other labor disputes. NOW, et al. sued Scheidler et al. alleging violations of the Racketeer Influenced and Corrupt Organizations (RICO) statute and the Hobbs Act. The defendants argued that since their actions were not motivated by economic gain, RICO was not applicable. The Court's 1994 decision was simply that "RICO contains no economic motive requirement."

Case Remanded

The case was remanded to the trial court, which found that the anti-abortion protesters were guilty of 121 acts that violated RICO and/or the Hobbs Act. The Seventh Circuit Appeals Court upheld the judgment of the trial court. When the case returned to the Supreme Court in 2003, the Court found that, since the protesters did not receive any property from their victims as a result of their violence and threats, none of the acts of the protesters involved extortion or robbery. Therefore the protesters did not violate RICO. Remaining, however, were four acts of violence and threats in which no allegation of extortion or robbery was made, but which could have violated the Hobbs Act. That was the issue decided by the Court in February.

NOW wanted the Act to be read to say that it proscribes any obstruction, delay, or interference with commerce by any of three means: (1) robbery, (2) extortion, or (3) acts and threats of violence that do not involve robbery or extortion. The AFL-CIO didn't want number three to stand alone. It wanted robbery and/or extortion to be required before a violation of the Act can be found. If the Court accepted stand-alone violence and threats as Hobbs violations, the Court may later decide to revisit its *Enmons* decision, which exempted unions from the Act on the grounds that violent strike actions, by themselves, do not involve robbery or extortion when undertaken in pursuit of "legitimate" union objectives.

During oral argument Justice Stephen Breyer expressed concern that if NOW prevailed in *Scheidler III*, routine union violence during strikes could become "a major federal crime." He and other seven justices who participated in the decision came down on the side of the AFL-CIO. Tragically to protect the illicit privileges given to unions, the Court extended them to abortion protesters.

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If schooling is made compulsory and "free,"
people with low incomes will almost always contribute
to its cost from their tax contributions,
however modest. But suppose this same sum was collected
not as now, but at the door of
their chosen school in the form of a tuition fee.
The consequence would be considerable family
protection against inferior service.
This was the main point urged by the early political
economists. Its cogency meanwhile
is measured by the anxiety of the current school monopoly
to attack it immediately wherever it appears.

— E.G. West, "Classical Libertarian
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